THE REVIEW OF AUSTRIAN ECONOMICS

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Volume 6, Number 1

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The Development of Keynes's Economics: From Marshall to Millennialism

Joseph T. Salerno*

One long-standing interpretation of the *General Theory*, which has been growing in influence recently, emphasizes that Keynes's sociopolitical vision was formulated long before and, in fact, inspired the heterodox economic analysis and policy prescriptions that were served up in his most influential work. One of the earliest proponents of this interpretation, Joseph Schumpeter ([1951] 1965, p. 268) writes that "In those pages of the *Economic Consequences of the Peace* [published in 1919] we find nothing of the theoretical apparatus of the *General Theory*. But we find the whole of the vision of things social and economic of which that apparatus is the technical complement. The *General Theory* is the final result of a long struggle *to make the vision of our age analytically operative*."

More recently this interpretive thread has been taken up by scholars who can be classified mainly, though not exclusively, as opponents of textbook Keynesian economics. For example, in a recent article on "The Sociopolitical Vision of Keynes," the late Karl Brunner reaches a conclusion similar to Schumpeter's. According to Brunner (1987, p. 32), "The general direction of Keynes's sociopolitical thoughts had . . . already emerged many years before he wrote the *General Theory*. . . . [The latter work] provided the underlying vision of the socioeconomic process in an extensive analytic context. The sociopolitical program outlined over the prior decade naturally fitted with the *General Theory* into a coherent story of modern Western society."

In another recent contribution, Allan Meltzer (1988, p. 5) declares that "[i]t is nearer the truth to say that the *General Theory* provided

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the analytic framework for Keynes's long-standing policy views than to conclude that the books' [sic] policy recommendations are the derived implications of his theory." Finally the post-Keynesian Hyman P. Minsky may be cited. Echoing Schumpeter, Minsky (1975, p. 145) writes:

> In an interpretation of Keynes's views on the implications of *The General Theory* for broader social issues and on the appropriate structure of policies designed to implement the new theory, his writings on politics and social policy prior to *The General Theory* are relevant. While *The General Theory* marks a sharp break in economic theory, the "social philosophy" implications he drew from the work are consistent with his earlier views. In fact, *The General Theory* can be viewed as giving an economic theoretic rationalization for views that Keynes's ethics and intuition had led him to, even as he was a practicing "classical" economist.

Textbook Keynesians, on the other hand, who generally are wont to emphasize the Great Depression as the main intellectual stimulus to the formulation of the "vision" underlying the *General Theory*, strongly demur from the Schumpeterian interpretation. For instance, in discussing Brunner's contribution cited above, Lester Thurow (Brunner 1987, p. 52) flatly states that "The *General Theory* would not have been written without the Great Depression." In his comment on Brunner, James Tobin (Brunner 1987, p. 53) expresses agreement with Thurow that the *General Theory* was presented as "a diagnosis of the world economic crisis of the Great Depression."

In this paper I shall argue that when the nature and evolution of Keynes's "vision" is fully grasped, the Schumpeterian and neo-Keynesian views of the *General Theory* are complementary rather than antithetical. It is indeed true that Keynes's ethical and sociopolitical views were formulated long before the writing of the *General Theory* and inspired and suffused the heterodox vision of the economic system presented in the book. But it is also true that prior to the onset of the Great Depression and up through 1931, in theorizing about the capitalist economy, Keynes proved to be a rigidly orthodox and parochial Marshallian economist, despite the idiosyncratic refinements and contrivances he introduced into Cambridge monetary theory in his *Treatise on Money*. It was not until 1932, at the earliest, that Keynes set himself to the task of overturning the Marshallian orthodoxy by undertaking the construction of a deliberately heretical economics explicitly based upon and embodying concepts and precepts derived from his ethical and social philosophy.

Keynes's social philosophy, the rudiments of which can already be found in *The Economic Consequences of the Peace* and which was

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expounded in widely scattered articles, book reviews, and speeches throughout the 1920s and early 1930s, can be classified as "millennialist." Although there are numerous variants of social millennialism or chiliasm, including those based on Christian theology and Hegelian philosophy (Rothbard 1990), what is common to all is the view that social evolution is teleological and, from a specific starting point, progresses along a necessary and definite course to a pre-ordained end. All millennialist theories are therefore presented as theories of historical stages in which human history is foretold as coming to a close in a paradisiacal final stage or millennium.

The teleological aspect of social millennialism has been well-described by Ludwig von Mises ([1936] 1951, p. 287):

> The teleological view describes the course of [social] evolution in all its windings and deviations. Thus it is typically a theory of stages. It shows us the successive stages of civilization until one is reached which must necessarily be the last, because no other follows it. When this point has been reached it is impossible to foresee how history is to proceed.

As a consequence of their teleological orientation, millennialist theories are inherently esoteric, gnostic, and antirationalist, involving the explicit or implicit assumption that the theorist or prophet alone possesses gnosis or direct intuition of the truths of social evolution.

Before examining Keynes's specific theory of social evolution, it is useful to broadly contrast this general characterization of millennialist theories with the approach to social evolution that I have elsewhere designated as "social rationalism" (Salerno 1990). The rationalist approach is methodologically individualistic and seeks for the ultimate explanation of social evolution in the perceived benefits which accrue to individuals as a result of their participation in the social division of labor. The rationalist approach is thus nonteleological and eschews any attempt to foretell the exact course of human history. Social progress is identified with the intensification and extension of the social division of labor, which proceeds from the recognition by ever-increasing numbers of individuals and groups that it is advantageous to endeavor to satisfy a growing number of wants by consciously organizing their productive activities in accordance with the law of comparative advantage (Salerno 1990, pp. 27–31). As Mises ([1936) 1951, p. 287) points out, in the rationalist view, "[t]he end of social evolution can be no other than that of society itself." The law of comparative advantage which is "the law of social evolution" yields "insight, not into man's destiny, but into man's doings" (Mises [1936] 1951, pp. 287–88).

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Because the rationalist theorist relies only on ratiocinative processes in formulating his explanation of the evolution of society, his theory is exoteric and subject to critical examination and refutation by other reasoning beings. Indeed, in order for much progress to be made toward the formation of a world-embracing division of labor and market society, the law of comparative advantage requires conscious affirmation by human reason. In history, this affirmation takes the form of the deliberate development and popular acceptance of a coherent ideology of social life which supports human liberty, private property, and a market economy, while abhorring political omnipotence, privilege, and warfare (Salerno 1990, pp. 46–53). The millennialist approach, on the other hand, posits the existence of a metaphysical and supra-rational force which, through "the cunning of History," drives human beings to those actions which are necessary to the achievement of humanity's final goal.

In the next section, I provide a brief overview of Keynes's most important intellectual influences. These influences are small in number and relatively parochial, involving two Cambridge dons and a British political theorist. In creating his sociopolitical vision, Keynes drew mainly upon the ethical philosophy of G. E. Moore, the political philosophy of Edmund Burke, and the economics of Alfred Marshall. From Marshall, Keynes also adopted the millennialist theoretical framework which the former constructed as a prop for his "preaching of mid-Victorian morality, seasoned by Benthamism" (Schumpeter [1951) 1965, p. 104).

In section 3, I trace the development of Keynes's millennialist theory of social evolution, upon which, I argue, his sociopolitical vision is based. I also suggest that, during the decade of the 1920s, in which this development mainly occurred, Keynes viewed Marshallian economics as a tool for guiding a dynamic and useful but unsteady and unethical capitalist economy toward the impending post-scarcity millennium and that his *Treatise on Money* (Keynes [1930] 1958) was intended as a handbook for just this purpose.

Section 4 contains an account of Keynes's apostasy from Marshallian economics in consequence of the Great Depression and his endeavor, beginning in 1932, to formulate a heretical body of economic analysis and policy, which was designed to effect a rapid transition to the millennium. In the fifth and concluding section of the paper, I present the case that the basic building blocks of the *General Theory*, including the theories of effective demand and liquidity preference and the concept of the marginal efficiency of capital, are fashioned out of the Moorite ethical precepts that Keynes presumed would guide action in his imagined millennial state.

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Keynes's Intellectual Influences

G. E. Moore served as Keynes's guide in his conception and pursuit of the ethical good. In Keynes's interpretation of Moore, ethical goodness or "the Good" is an attribute uniquely related to "states of mind," which are the only things valuable in and of themselves. In elaborating upon his version of the Moorite "religion," Keynes (quoted in Skidelsky [1983] 1986, p. 141) writes:

> Nothing mattered except states of mind. . . . These states of mind were not associated with action or achievement or with consequences. They consisted in timeless passionate states of contemplation and communion, largely unattached to "before" and "after." . . . The appropriate subjects of passionate contemplation and communion were a beloved person, beauty and truth, one's prime objects in life were love, the creation and enjoyment of aesthetic experience and the pursuit of knowledge. . . . [The Moorite] religion was altogether unworldly—with wealth, power, popularity or success it had no concern whatever, they were thoroughly despised.

According to Keynes (quoted in Skidelsky [1983] 1986, p. 142), he and the other early proselytes of Moore's religion:

> lived entirely in present experience, since social action as an end in itself and not merely as a lugubrious duty had dropped out of our Ideal, and not only social action, but the life of action generally, power, politics, success, wealth, ambition, with the economic motive and economic criterion less prominent in our philosophy than with St. Francis of Assisi, who at least made a collection for the birds.

Thus the Moorite contribution to Keynes's thought is a concept of the highest good as consisting in a succession of timeless states of consciousness to be experienced in the present moment. There is further a tendency in Moore to treat these internal states of goodness as wholly independent of any external means for their achievement. As Skidelsky ([1983] 1986, p. 146) points out, not only is economic welfare not the same as ethical goodness, "there is nothing in Moore's argument to show that it is a necessary condition of it." Thus Keynes absorbed a radical present orientation from Moore's thought and a related tendency to denigrate "economizing" or purposeful behavior associated with scarcity, since attainment of ethical goods did not directly depend upon—indeed was inhibited by—the undertaking of time-consuming processes of production employing scarce means.

On two crucial points, however, Keynes broke with Moore. First, while he accepted the sharp distinction drawn by Moore between economic welfare and ethical goodness, Keynes struggled mightily to

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forge a logical link between economic, social, and political goods on the one hand and the Moorite ethical good on the other. Keynes supplies this link by conceiving the existence of society as an absolute and necessary precondition for the realization of the individual's "good states of mind." The overall social good, including economic welfare, while not intrinsically good, is therefore to be sought after as a "useful" and "valuable" means to the ultimate end of the ethical good (Skidelsky [1983] 1986, p. 154). For Keynes, however, because the ethical quality of the end could never be imputed to or reflected by the means, the Good is always to be valued absolutely above its means of attainment, thereby precluding the logical development of a universal principle on which resources are to be allocated between the immediate attainment of good states of mind and the securing of conditions that may be useful for their attainment in the future. Thus the claim of the ethical good on behavior appears to be absolute, indivisible, and beyond the pale of scarcity and economic science. Of course, Keynes did believe that non-ethical ends had a claim on behavior in certain circumstances, but, as Skidelsky ([1983] 1986, p. 154) states, "the connection [between economics and ethics] for Keynes was never mechanical, always problematic."

For guidance in identifying the social good and the proper method for its achievement, Keynes turned to the political philosophy of Edmund Burke. As Skidelsky ([1983] 1986, p. 154) states, "[i]f Moore was Keynes's ethical hero, Burke may lay strong claim to be his political hero."

Keynes (quoted in Skidelsky [1983] 1986, p. 155) broadly characterized Burke as a utilitarian, for whom politics and government were the essential means to securing the "happiness of the people" in the form of "physical calm, material comfort, and intellectual freedom." For Keynes these qualities are, in turn, the "great and essential means" for the attainment of the ultimate Moorite "good things" in life, which flow from the cultivation of the "tastes and emotions, good feeling and right judgment."

According to Keynes (quoted in Skidelsky [1983] 1986, p. 155), one of the most important corollary principles of Burkean utilitarianism is an "extreme timidity in introducing present evils for the sake of future benefits." In support of this principle, Keynes argued that:

> Our power of prediction is so slight, it is seldom wise to sacrifice a present evil for a doubtful advantage in the future. Burke ever held, and held rightly, that it can seldom be right to sacrifice the well-being of a nation for a generation, to plunge whole communities in distress, or to destroy a beneficent institution for the sake of a supposed millennium in the comparatively remote future. . . . It

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> is the paramount duty of governments and of politicians to secure the well-being of the community under the case in the present and not to run risks overmuch for the future.

Keynes (quoted in Skidelsky [1983] 1986, p. 157) summed up Burke's political philosophy in the following terms:

> His goods are all in the present—peace and quiet, friendship and affections, family life, and those small acts of charity whereby one individual may sometimes help his fellows. He does not think of the race as marching through blood and fire to some great and glorious good in the distant future; there is, for him, no great political millennium to be helped and forwarded by present effort and present sacrifice.

Thus, Keynes derived two things from Burke: (1) the belief that government and politicians are competent to directly secure the material conditions that foster "general happiness" or "the wide dissemination of comfort" and that are also the means for attaining the spiritual or mental states that constitute the ultimate good; and (2) a strong present orientation in policy matters which dovetails with the severely foreshortened time horizon that is entailed by acceptance of Moore's notion of the ethical good.

The second point on which Keynes disputed his mentor on ethics involves probability theory. As a utilitarian, Moore contended that it is rational to pursue one's own immediate good only if this pursuit will, on balance, increase or at least not decrease the good of the Universe. However, in attempting to judge which course of action is rational in this sense, the individual actor is confronted with the daunting task of correctly forecasting and assessing the myriad consequences of his action, which may ramify into every corner of the remote future. The insuperable difficulty of this task leads Moore (quoted in Skidelsky [1983] 1986, p. 152) to argue that "[o]ur utter ignorance of the far future gives us no justification for saying that it is even probably right to choose the greater good within the region over which a *probable* forecast may extend." Moore concludes, therefore, that, in most cases, an individual rationally pursuing the ethical good can do no better than to conform to general rules of conduct, such as those embodied in the dictates of conventional morality.

Keynes reacted to this argument by challenging Moore's underlying approach to probability, which Keynes identified as a frequency theory of probability involving certain knowledge of the distribution of outcomes. In Keynes's view, the concept of probability which is relevant to action is one which refers to the available evidence regarding alternative actions. A proposition about the outcome of a

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contemplated action is more probable than a proposition regarding an alternative outcome, if, however slight the presently existing evidence, it indicates that the first outcome is more likely than the second. As Keynes ([1921] 1962, pp. 307, 310) states:

> Given as our basis what knowledge we actually have, the probable . . . is that which it is rational for us to believe. . . . To believe one thing *in preference* to another, as distinct from believing the first true or more probable and the second false or less probable, must have reference to action and must be a loose way of expressing the propriety of *acting* on one hypothesis rather than another. . . . We might put it, therefore, that the probable is the hypothesis on which it is rational for us to act. . . . The results of our endeavors are very uncertain, but we have a genuine probability, even when the evidence upon which it is founded is slight. . . .

With this theory of probability, Keynes is able to free the Moorite pursuer of good mental states from the shackles of conventional rules of correct conduct that were clamped on by Moore himself as a utilitarian concession to the uncertain future. According to Keynes ([1921] 1962, pp. 309–10): "If good is additive, if we have reason to think that of two actions one produces more good than another in the near future, and if we have no means of discriminating between their results in the distant future, then by what seems a legitimate application of the Principle of Indifference we may suppose that there is a probability in favor of the former action." Thus, the claims of the immediate good upon action are even stronger for Keynes than for Moore, because Keynes's theory of probability permits him to ignore the unforeseeable future ramifications of present action.

The final major influence on Keynes's social philosophy is his mentor in economics, Alfred Marshall. Marshall's influence on the early Keynes is difficult to overestimate. From all accounts, Keynes the economist was steeped in Marshall. Dating from his academic appointment to Cambridge in 1909, Keynes "taught straight Marshallian doctrine . . . the doctrine he mastered as few people did and with which he remained identified for twenty years to come" (Schumpeter [1951] 1965, p. 263).

Revelations of Keynes's astonishing parochialism in economic theory are provided by Harrod, his disciple and authorized biographer. In urging the young Harrod to attend Cambridge, Keynes "brushed aside" the London School of Economics and rejected the alternative of a foreign university because, according to Keynes, "they knew nothing at all of Economics on the Continent" (Harrod 1951, p. 319). Harrod (1951, p. 322) refers to "Keynes's dictum that there wasn't any place but Cambridge where one could learn economics."

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After enrolling at Cambridge, Harrod was impressed by Keynes's view that "the content of economic theory was extremely small" and that "wide reading in economic theory" was not necessary. Keynes believed, as Marshall had, that "there was not much further work to be done" in the field of economic theory, and Keynes's "recipe for the young economist was to know his Marshall thoroughly and read his *Times* every day carefully, without bothering too much about the large mass of contemporary publication in book form" (Harrod 1951, p. 324).

More recently, Moggridge (1976, p. 153) has affirmed that "broadly Marshallian modes of analysis pervade all Keynes's work, even when Marshall and his successors were the objects of attack, as in the *General Theory*."

In the judgment of his fellow Cantabrigian, A. C. Pigou (quoted in Keynes 1973, p. 22), even after he discarded some of the technical apparatus of Marshallian theory in the 1930s Keynes remained, in terms of his philosophical approach to economics as a branch of applied ethics, "a firm disciple of the 'Master.'" As late as 1938, for example, Keynes defended Marshall's view, as against Robbins's, that economics is "a moral science" which "employs introspection and judgments of value" (Moggridge 1976, p. 22).

Writing in 1941, Keynes (quoted in Hession 1984, p. 326) described the doctrinal filiation of his own intensely ethical approach to economics in the following terms:

> Along one line of origin, at least, economics more properly politico-economy is a side of ethics. Marshall used always to insist that it was through ethics he arrived at political economy, and I would claim myself in this, as in other respects, to be a pupil of his. I should have thought that nearly all English economists in the tradition, apart from Ricardo, reached economics that way. There are practically no issues of policy as distinct from technique which do not involve ethical considerations.

Accordingly, one of the main props for Keynes's social philosophy is the value-laden theory of wants developed by Marshall. Marshall's classification of wants is threefold. "Natural" human wants refer to the biological needs for, e.g., food and shelter, which characterize both the lower animals and uncivilized man. According to Marshall ([1920] 1949, p. 86), the wants in this class "are countless in number and very various in kind: but they are generally limited and capable of being satisfied." As civilization progresses, however, there emerges a second class of "artificial" wants, which are not capable of satiation. Marshall ([1920] 1949, p. 88) includes in this class the craving for distinction among one's fellows which, for example, in the case of

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women's dress, gives rise to "the evil dominion of the wanton vagaries of fashion."

Marshall's third category encompasses "wants adjusted to activities." In the early stages of social evolution, wants are the prod to human "activities," which are aimed almost exclusively at satisfying these wants. In the higher stages, in which natural wants have been satisfied, "higher" activities begin to be undertaken for their own sake leading to the creation of wants. Marshall's example of this inverted relationship between wants and activities is the pursuit of science, literature, and art for their own sake, generating a demand for the labor of those who pursue these activities professionally (Marshall [1920] 1949, pp. 88–89). The rapid increase in the consumption of tea, while the consumption of alcohol stagnates, affords another illustration, because, according to Marshall ([1920] 1949, p. 89 1n), tea is desired to "stimulate the mental activities," just as alcohol serves to "merely gratify the senses." As the pursuit of higher activities becomes increasingly widespread in society, there emerges a pervasive "desire for excellence for its own sake" causing the processes of production, heretofore seen as merely a means to want satisfaction, to be transformed into higher activities pursued as ends in themselves. Thus the work of the fisherman begins to take on the character of the "activities" of a Newton or a Stradivarius (Marshall [1920] 1949, p. 89). For Marshall (quoted in Parsons [1937] 1968, p. 141 1n), then, "[w]ork in its best sense, the healthy energetic exercise of faculties is the aim of life, is life itself."

Marshall's theory of wants and activities serves as the basis of his theory of social evolution, which also deeply influenced Keynes. Thus Marshall ([1920] 1949, p. 85) tells us that "it is to changes in the forms of efforts and activities that we must turn when in search for the keynotes of the history of mankind." The reason is that "man's character has been molded by his every-day work, and the material resources he thereby procures, more than any other influence unless it be that of his religious ideals" (Marshall [1920] 1949, p. 1). Human character is thus developed in the very process of economic and social evolution in which, in the later stages, "each new step upwards is to be regarded as the development of new activities giving rise to new wants" (Marshall [1920] 1949, p. 89).

Most important for Marshall, economic and social progress is expressed in a "rising standard of life," a term which Marshall never clearly defines but which can be understood as "some kind of index of human quality: a scalar function of a vector of attributes or 'activities,' physical or mental, such as energy, dexterity, rationality, foresight, honesty, unselfishness, striving for self-improvement and

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social improvement, and so on" (Whitaker 1977, p. 180). An increase in the standard of life implies, e.g., a reduction of expenditure on debilitating alcoholic beverages and an increase of expenditure on healthful food and drink and children's education, as well as an increase in saving and therefore capital accumulation. The resulting improvement in the laborer's health, morale, and human capital as well as in the material structure of complementary capital goods will tend to increase labor efficiency and real wage rates. Increased wage rates will, in turn, provide the wherewithal, including the greater opportunity for the enjoyment of leisure, which is needed to satisfy the wants induced by the pursuit of "higher activities" (Whitaker 1977, 179, pp. 184–85).

Marshall's almost obsessive emphasis on leisure—albeit leisure to pursue ennobling or "higher" activities—as a prerequisite of character development and social progress should be noted. In his own words, "Some free time from the fatigue of work that tires without educating, is a necessary condition of a high standard of life." For the young, in particular, it is "an essential condition" for developing "their higher nature" and making them "efficient producers" that they be given "long-continued freedom from mechanical toil; together with abundant leisure for school and for such kinds of play as strengthen and develop the character" (Marshall [1920] 1949, p. 720).

The improvement of character that results from higher activities pursued during leisure time will further heighten the standard of life and lead to a further round of improvement in consumption habits and of increased investment in material and human capital, with the consequent increase in real wages starting the whole process over again. Marshall ([1920] 1949, p. 690) implies, however, that this development process may be short-circuited if an increase in real wage rates is squandered on increasing the "standard of comfort," by which he means "a mere increase of artificial wants, among which perhaps the grosser wants may predominate."

And if the masses persist in wallowing in a degraded standard of life, thereby obstructing social progress, Marshall ([1920] 1949, p. 714) suggests a two-pronged solution. The "residuum," or those who are "physically, mentally or morally incapable of doing a good day's work with which to earn a good day's wage," are to be prevented from perpetuating themselves by rearing up children "in their own patten." To this end, those with young children are to "come under a paternal discipline" and to incur "a more strict subordination of personal freedom to public necessity." As a last resort, Marshall ([1920] 1949, pp. 714–15 1n) advocates that "the homes might be closed or regulated with some limitation on the freedom of the parents."

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Marshall's second method of "causing the residuum to cease from the land" and hastening social progress involves "the application of the principles of Eugenics to the replenishment of the race from its higher rather than its lower strains. . . ." (Marshall [1920] 1949, pp. 714, 248). Theodore Levitt (1976, p. 429) perceptively refers to this second method as "the ultimate solution," because "ultimately what Marshall preached was not so much economics as it was moral and aesthetic development."

Although Marshall advocated a political solution to the problem of the residuum, "It was free enterprise, softened and modified by altruism and chivalry, which was to be the main agent of human evolution" (Whitaker 1977, p. 181). According to Marshall, as society progressed, men in the realm of business would increasingly foreswear the single-minded pursuit of the coin of pecuniary gain and substitute competition for the coin of chivalric achievement and the social acclaim and approbation it purchased. In this way business activities would come to resemble the arts and sciences. Such "chivalrous competition," to use Marshall's term, would be undertaken primarily as a "higher activity," which, as Whitaker (1977, p. 173) describes it, unites "public spirit and conscientiousness with a delight in doing noble and difficult things and a desire for full exercise of one's own abilities."

As members of the middle and upper classes come to exert themselves more and more for chivalric motives, the supply prices of the various kinds of managerial and professional effort, especially of what Marshall ([1920] 1949, p. 618) calls "business ability in command of capital," decline absolutely and relative to the wage rates of the more common grades of labor, and this effects a spontaneous redistribution of income toward the working class. As Marshall (quoted in Whitaker 1977, p. 174) puts it, "if society could award . . . honor, position, and influence by methods less blind and wasteful; and if it could at the same time maintain all that stimulus which the free enterprise of the strongest business men derives from present conditions, then the resources thus set free would open out to the mass of the people new possibilities of a higher life." Thus does chivalrous competition promote social evolution, permitting members of the working class to attain to the "society of gentlemen" wherein "no one is to do in the day so much manual work as will leave him little time or little aptitude for intellectual and artistic enjoyment in the evening" (Marshall quoted in McWilliams-Tullberg 1975, p. 102).

As noted above, all millennialist social theories are essentially teleological, typically attempting to describe the precise course of

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evolution by positing a series of well-defined historical stages through which society must evolve before reaching its final goal in the culminant stage of human history. Now this is certainly typified by Marshall's theory of social evolution. This theory is centered upon what Talcott Parsons ([1937] 1968, p. 158) has identified as "Marshall's belief in an absolute goal of evolution, the development of character in his peculiar sense." Marshall (quoted in Whitaker 1977, p. 183) himself describes the final stage of social evolution as a state with "no rights but only duties; where everyone shall work for the public weal with all his might expecting no further reward than that he in common with his neighbors shall have whatever is necessary to enable him to work well, and to lead a refined and intellectual life." In a more mature work, Marshall (quoted in Levitt 1976, p. 439) posits a "distant goal where the opportunities of the noble life may be accessible to all."

In the *Principles*, Marshall ([1920] 1949, p. 752) gives a decidedly Hegelian cast to his desiderated millennium, referring to "an order of social life, in which the common good overrules individual caprice, even more than it did in the early ages before the sway of individualism had begun. But unselfishness then will be the offspring of deliberate will; and, though aided by instinct, individual freedom will develop itself in collective freedom. . . ." Thus, for Marshall, human history is to culminate in what we may call the Era of the Noble Life, in which all human activities, from sipping tea to mining coal, are completely transformed into "higher activities" not driven by wants but undertaken as an aid to or an exercise of the higher human faculties.

Before society can enter into this paradisiacal state, however, humanity and the human character must be prepared by passing through two earlier stages. In the first stage, let us call it the "Era of Scarcity," almost all human activities are directed toward solving the problem of scarcity, conceived of in Marshall's peculiar and narrow sense of satisfying *basic* human wants. The transitional stage or the "Era of Chivalry" dawns with the arrival of the Victorian gentleman upon the scene: the solution of the economic problem for at least some segments of the population yields the leisure and material resources necessary to an enhanced "standard of life" marked by the pursuit of character-developing and productivity-improving higher activities. The resulting character development effects a progressive transformation of the motive, from pecuniary to chivalric, for which capital is invested and business activities are undertaken, thereby lowering the supply price at which "business ability in command of capital" is forthcoming and raising the real wages of

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the working class. In this way, free enterprise conducting itself in accord with chivalrous competition will insure that the resources and opportunities for character development and a rising standard of life trickle down to the working classes.

To the extent that members of the working class invest the newly won additions to their incomes in the acquisition of higher skills for themselves and for their offspring, the supply of unskilled labor will eventually diminish, augmenting the rise in the real wages of the unskilled and offering increased access to a higher standard of life. The residuum who, due to defect of will or ability, do not avail themselves and their children of this opportunity for character improvement will be eventually suppressed by compulsory State education and supervision of child rearing and, in the last resort, of reproductive activities. Thus will the chivalrous and duty-bound Victorian businessman, abetted by a bracing dose of State paternalism and eugenics administered to the physically and morally unfit, usher humanity into the Era of the Noble Life.

Marshall's theory of social evolution leads to a peculiar conception of the economic problem confronting humanity. Construed conventionally as the confrontation between virtually limitless human wants and limited resources, scarcity is not the permanent problem burdening humanity. For Marshall, the central problem of economic science and of social evolution is the devising of a framework for society's business and productive activities which promotes the unimpeded development of human character. To put it another way, once the Era of Scarcity has been transcended, consumption is no longer the *end* of production but the *means* which permits men to "work well" and improve their standard of life. Thus Marshall ([1920] 1949, pp. 530, 193) proclaims that the "end of all production" is to "raise the tone of human life" and that "the chief importance of material wealth lies in the fact that, when wisely used, it increases the health and strength, physical, mental and moral of the human race."

What Marshall ([1920] 1949, p. 85) calls the "keynote of the history of mankind," therefore, is not the struggle against scarcity, which is an ephemeral condition capable of resolution, but the proper development of human character. Marshall (quoted in McWilliams-Tullberg 1975, p. 93) is emphatic on this point, declaring that "I have always held that poverty and pain, disease and death are evils of greatly less importance than they appear, except in so far as they lead to weakness of life and character. . . ." The *raison d'être* of economic science is therefore to study the evolutionary process of human character formation in order to guide it to its fruition in the millennium of the Noble Life. In Marshall's words (quoted in Whitaker 1977,

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p. 179): "[The] progress of man's nature . . . is I conceive, the center of the ultimate aim of economic studies. . . . human will, guided by careful thought, can so modify circumstances as largely to modify character; and thus to bring about new conditions of life still more favorable to character; and therefore to the economic, as well as moral well-being of the masses of the people."

In a revealing comment, Keynes (quoted in Whitaker 1977, p. 185) observes that "[t]he solution of economic problems was for Marshall, not an application of the hedonistic calculus, but a prior condition of the exercise of man's higher faculties." In fact, as we shall now see, Keynes adopted Marshall's view of the economic problem as well as the latter's millennialist vision of social evolution.

The Development of Keynes's Sociopolitical Vision

Keynes's social philosophy and particularly his theory of social evolution are not coherently stated in any one of his works but must be pieced together from scattered discussions in articles and books written over the span of more than a decade. Nevertheless, this endeavor does lead us to view Keynes as a consistent and thoroughgoing millennialist in his approach to social evolution.

We get an early and brief glimpse of Keynesian themes in this area in *The Economic Consequences of the Peace*, first published in 1919 (Keynes [1920] 1971). In a chapter on "Europe before the War," there appears a section blandly entitled "The Psychology of Society." In little more than four pages, Keynes suggests the fundamental irrationality of abstaining from present consumption, emphasizes the importance of capital accumulation and compound interest to social evolution, delineates a teleological approach to human history whose goal is inexplicably known to him, and speculates on an evolutionary solution to the problem of scarcity. All of these themes were absorbed from his mentors and were to become hallmarks of Keynes's later works.

To begin with, Keynes ([1920] 1971, p. 19) points to the "immense accumulations of fixed capital" which occurred, "to the great benefit of mankind," in the fifty years leading up to the World War I and attributes these to the inequality of the distribution of wealth in favor of that class least likely to consume it. Thus the maintenance and accumulation of capital depends on what Keynes ([1920] 1971, p. 19) calls "a double bluff or deception." On the one hand, the laboring classes were deceived into accepting "a situation in which they could call their own very little of the cake that they and Nature and the capitalists were cooperating to produce" (Keynes [1920] 1971, p. 20). The capitalists, on the other hand, were equally deceived because, although

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the greatest part of the national income "cake" accrued to them, it could remain in their possession only "on the tacit underlying condition that they consumed very little of it in practice" (Keynes [1920] 1971, p. 20). Any attempt by the capitalists to exercise their *de jure* right to expend their vast accumulation of wealth on present consumption would provoke the wrath of the much more numerous laboring class and result in the capitalists' expropriation.

But how was this elaborate deception maintained, by whom, and to what end? According to Keynes, the deception was maintained by ordaining saving as a virtue and the consequent growth of the capital structure and national income as "the object of true religion." Says Keynes ([1920] 1971, p. 20), "There grew round the non-consumption of the cake all those instincts of puritanism which in other ages has withdrawn itself from the world and has neglected the arts of production as well as those of enjoyment." But, clearly, saving or "the non-consumption of the cake" is, from the individual's point of view, without reason or purpose. The conventional motives of saving for one's dotage or for one's offspring, Keynes ([1920] 1971, p. 20) suggests, were based on a self-delusion, for "the virtue of the cake was that it was never to be consumed, neither by you nor by your children after you."

Who is the perpetrator of this grand deception and the founder of the false religion of saving? Keynes's answer is a hypostatized Society, which is wisely propelling humanity forward to the millennium through the actions of the deluded savers and investors. Writes Keynes ([1920] 1971, pp. 20–21):

> In the unconscious recesses of its being Society knew what it was about. The cake was really very small in proportion to the appetites for consumption, and no one, if it were shared all round, would be much the better off by the cutting of it. Society was working not for the small pleasures of today, but for the future security and improvement of the race. . . .

The progressive accumulation of capital insures that, eventually, Society reaches its pre-ordained goal, the problem of scarcity is resolved and the millennium is at hand. As Keynes ([1920] 1971, p. 21) prophesies, "[i]n that day overwork, overcrowding, and underfeeding would have come to an end, and men, secure of the comforts and necessities of the body, could proceed to the nobler exercises of their faculties." Note that Keynes's brief description of the millennial state reflects the narrow Marshallian conception of scarcity as the inability to provide for the basic human wants of food, shelter, and clothing. Once such biological needs are adequately met, humanity is freed from the shackles of scarcity to pursue, if it only will, ennobling activities.

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Note also that, for Keynes, the primary force propelling humanity toward its destiny is not Marshallian free enterprise rendered pure and chivalrous but capital accumulation pure and simple. This is why, as Brunner (1987, p. 37) has recognized, "Keynes was very much concerned with the accumulation of real capital in modern economies." As we will see, Keynes never wavered in his belief that capital is the foremost agent of social transformation.

Also noteworthy is Keynes's view that the accumulation of capital and, hence, the progress of society toward the millennium depends on a thoroughly irrational propensity of human beings to save. This poses a conundrum of great moment which Keynes, at this early stage, attempts to resolve by reference to mysterious social forces that perpetrate a "double bluff." The bluff misleads two classes of individuals, capitalists and laborers, whose interests are irrevocably opposed, into undertaking activities and entering into social arrangements that are in the interests of neither class. But Keynes was understandably uneasy with this resolution and, as I shall argue below, the evolution of Keynes's technical economics can be viewed as a long struggle to unravel the conundrum.

In a series of articles written in the 1920s, Keynes further transformed Marshall's millennialist vision by incorporating additional elements of Moore's philosophy into it. In particular, Keynes called into question what was firmly averred by Marshall: the intrinsic value of the activities and mental states inspired by competitive capitalism. Keynes also emphatically rejected Marshall's belief that humanity's millennium lay in the distant future and that progress toward this desideratum still demanded stiff present sacrifices. For Keynes, the millennium was close at hand, and humanity would be wise to sample its fruits in the present.

In "A Short View of Russia," first published in 1925, Keynes ([1931] 1963, pp. 297–311) favorably contrasts the religious spirit at the core of Russian communism to the spiritual poverty that attends the pursuit of money-making under modern capitalism. According to Keynes ([1931] 1963, pp. 302–03),

> [the] *emotional and ethical essence* [of Leninism] *centers about the individual's and the community's attitude toward the Love of Money.* . . . [I]n the Russia of the future it is intended that the career of money-making, as such, will simply not occur to a respectable young man as a possible opening, any more than the career of a gentleman burglar or acquiring skill in forgery and embezzlement. Even the most admirable aspects of the love of money in our existing society, such as thrift and saving, and the attainment of financial security and independence for one's self and one's family, whilst not deemed

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> morally wrong, will be rendered so difficult and impracticable as to be not worth while.

Even in the contemporary Russia he was observing, Keynes ([1931] 1963, p. 304) detected evidence of the denigration of money-making, remarking that "[t]he private trader is a sort of permitted outlaw, without privileges or protection, like the Jew in the Middle Ages—an outlet for those who have overwhelming instincts in this direction, but not a natural or agreeable job for the normal man." Keynes ([1931] 1963, p. 304) deems a society which treats money-making in this manner "a tremendous innovation."

In comparison to communism, Keynes ([1931] 1963, pp. 306–07) portrays capitalism as "absolutely irreligious, without internal union, without much public spirit, often, though not always, a mere congeries of possessors and pursuers." In order to survive in the face of its profound spiritual poverty and in the teeth of "religious Communism," capitalism must prove itself to be not merely more efficient than communism but many times more efficient. In Keynes's estimation, however, capitalism at the beginning of the twentieth century had proven itself to be only "moderately successful." In fact, in breach of another tenet of the Marshallian faith, Keynes wonders whether capitalism is losing its efficacy, and therefore its limited value, as a means of economic progress and social transformation.

Keynes ([1931] 1963, p. 307) confesses his doubts in the following terms:

> We used to believe that modern capitalism was capable, not merely of maintaining the existing standards of life, but of leading us gradually into an economic paradise where we should be comparatively free from economic cares. Now we doubt whether the business man is leading us to a destination far better than our present place. Regarded as a means he is tolerable; regarded as an end he is not so satisfactory.

If capitalism is not leading toward the millennium, then Keynes ([1931] 1963, p. 307) questions "whether the material advantages of keeping business and religion in different compartments are sufficient to balance the moral disadvantages." He explicitly rejects the "Protestant and Puritan" view that business and religion naturally belong to different domains, as well as the view of the Marshallian "believer in progress," who affirms capitalism "as the means to the establishment of heaven upon earth hereafter." In their place, Keynes counsels a radically present-oriented, Moorite "third state of mind," which exalts the pursuit and enjoyment of the ethical good in the here and now.

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According to Keynes ([1931] 1963, pp. 307–08), those who have attained to this third state of mind:

> do not fully believe either in a heaven which is elsewhere or in progress as a sure means towards a heaven upon earth hereafter; and if heaven is not elsewhere and not hereafter, it must be here and now or not at all. If there is no moral objective in economic progress, then it follows that we must not sacrifice, even for a day, moral to material advantage—in other words, that we may no longer keep business and religion in separate compartments of the soul.

Whether or not capitalism remains a useful means for further amelioration of the economic problem, Keynes affects no doubt as to its degraded moral quality, because it distracts men from the immediate enjoyment of exalted mental states, while absorbing their minds and lives in the love and pursuit of money and in its accumulation for an ever-receding future. Thus Keynes ([1931] 1963, p. 308) concludes that "it seems clearer every day that the moral problem of our age is concerned with the love of money, with the habitual appeal to the money motive in nine-tenths of the activities of life, with the universal striving after individual economic security as the prime object of endeavor, with the social approbation of money as the measure of constructive success, and with the social appeal to the hoarding instinct as the foundation of the necessary provision for the family and for the future."

In "Am I a Liberal?" also first published in 1925, Keynes ([1931] 1963, pp. 323–38) embraces the theory of stages of economic development outlined by the American institutionalist, Joseph R. Commons. Commons's first epoch, the Era of Scarcity, is marked by very little individual liberty and a great deal of coercive control exercised by governmental and other institutions. This, Keynes (1925, p. 334) tells us, was "the normal state of the world up to (say) the fifteenth or sixteenth century." The transition to Commons's Era of Abundance occurred in the seventeenth and eighteenth centuries and culminated "gloriously in the victories of *laissez-faire* and historic Liberalism" in the nineteenth century (Keynes [1931] 1963, pp. 334–35). In this epoch, individual liberty is given its full head and coercive political control is minimized.

The contemporary world, according to Keynes and to Commons, was in transition to the third stage, characterized by Keynes as the Era of Stabilization. Keynes ([1931] 1963, p. 335) argues that progress into this stage requires "[t]he transition from economic anarchy to a regime which deliberately aims at controlling and directing economic forces in the interests of social justice and social stability. . . ." No longer can "the economic Juggernaut [be] allowed

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to crash along the highway of Progress without obstruction and even with applause," as it was allowed to do in the nineteenth century (Keynes [1931] 1963, p. 337). For Keynes ([1931] 1963, p. 335), "*laissez-faire* individualism and the free play of economic forces" have outlived their usefulness while socialism offers no better alternative because both are "Sprung from the presuppositions of the Era of Abundance."

Like Moses, capitalism had gotten society within sight of the promised land but was morally unfit to enter. Now, Keynes believed, an alternative system must be devised and readied to secure humanity in its impending enjoyment of millennial bliss. Yet a more immediate source of concern for Keynes involved certain defects which he perceived in the technical operation of *laissez-faire* capitalism, particularly in the area of money, and which needed to be remedied to assure a smooth transition to the millennium. It was the task and destiny of what Keynes ([1931] 1963, pp. 335, 337) referred to as the "New Liberalism" to prepare the solutions to the immediate technical problems of the transition as well as to "invent new wisdom for a new age."

Unlike Marshall, Keynes did not foresee a spontaneous remedy for capitalism's technical shortcomings and moral failings in the replacement of the profit motive by Victorian chivalry. It was on this issue that Keynes abandoned Marshall for Burke.

Keynes's Burkean tract "The End of Laissez Faire," which first appeared in print in 1926, proposes an "Agenda of State," which is aimed at effecting "improvements in the technique of modern Capitalism by the agency of collective action" (Keynes [1931] 1963, p. 319). The criterion governing these agenda, according to Keynes ([1931] 1963, p. 317), is not to replace private decisionmaking with State decisionmaking but relates "to those decisions which are made by *no one* if the State does not make them." Three examples of the applicability of State agenda are given by Keynes.

First there are the "economic evils" associated with risk, uncertainty, and ignorance, including inequality of wealth, unemployment of labor, and reduction of efficiency and production. The State agendum in this matter lies in "deliberate control of the currency and of credit by a central institution" and "the collection and dissemination on a great scale of data relating to the business situation," including the legally coerced publication of all useful business facts (Keynes [1931] 1963, pp. 317–18). (Regarding the latter, business secrecy had been an especial bugbear of Marshall's.)

The second example Keynes ([1931] 1963, pp. 318–19) offers refers to saving and investment. In this area, the State agendum is to provide "a co-ordinated act of intelligent judgment" regarding how much the nation should save, what proportion of aggregate savings

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should be invested abroad, and whether the private capital market is channeling domestic investment to the most productive uses.

The third agendum of State mentioned by Keynes ([1931] 1963, p. 319) is control of the quantity and quality of the national population. Keynes still has enough of the classical economist in him to fear that the Malthusian devil may forever bar the door to the millennium by wasting the fruits of capital accumulation on sustenance for an ever-expanding population. Keynes's reference to the Marshallian devil of a genetically incorrigible residuum is veiled and tentative: "The time may arrive . . . when the community as a whole must pay attention to the innate quality as well as to the mere numbers of its future members" (Keynes [1931] 1963, p. 319).

Having contrived Burkean expedients for overcoming problems in its technique, Keynes once again expresses satisfaction, if only half-heartedly, that capitalism is capable of producing steady progress toward the millennium. Nevertheless, he is even more firmly convinced that a new system, which is consistent with Moorite ethical precepts, must be excogitated as a final replacement for the spiritually desolate capitalism. Donning the mantle of the millennialist prophet, Keynes boldly proposes to undertake this task by consulting his internal gnosis. Thus, he (Keynes [1931] 1963, pp. 321–22) concludes that:

> capitalism, wisely managed, can probably be made more efficient than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life.
>
> The next step forward must come, not from political agitation or premature experiments, but from thought. We need by an effort of the mind to elucidate our own feelings. . . . We need a new set of convictions which spring naturally from a candid examination of our own inner feelings in relation to the outside facts.

Apparently, Keynes took seriously the task he set himself in 1926 and he pondered long and hard on the problems of social evolution in the next few years. In 1930 he published "Economic Possibilities for Our Grandchildren," which is based on ideas expressed in a speech in early 1928 and wherein is presented a fully developed theory of humanity's path to "our destination of economic bliss" (Keynes [1931] 1963, p. 373). In particular, Keynes provides answers to some of the questions he raised in previous articles. Most importantly, he foretells the process by which human nature will be spontaneously purged of the pecuniary motive without the necessity of institutional transformation.

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While some of Keynes's disciples, including Harrod (1951, p. 399), discount its significance as a serious expression of Keynes's ideology, Hession (1984, p. 242) has insightfully characterized this article as "an important statement of his personal philosophy or *Weltanschauung*. . . . Indeed, this essay may be regarded as analogous to Marshall's 'Possibilities of Economic Chivalry' or to John Stuart Mill's speculations on the 'Stationary State,' both well-known examinations of the future of Western Society."

Significantly, in 1930, Keynes ([1930] 1958) also published his *Treatise on Money*, which he had been working on during the previous five years and which can be seen as a technical guide for carrying out the State's agenda with respect to the "gaps" in modern capitalism caused by uncertainty, foreign investment, and the lack of a mechanism for equating saving and investment. As I shall argue below, the *Treatise* was intended by Keynes to be a handbook to guide Burkean policymakers in their charge of keeping society on course and on time in the last leg of its journey to the millennium.

Keynes begins "Economic Possibilities" by emphatically reaffirming his faith in the continuation of economic progress in the face of widespread and growing doubt attributable to the slowdown of economic activity that was beginning to take hold in the world economy in 1930. In fact, Keynes regards the downturn, quite sanguinely, as evidence of the transition to the next stage of history. Opines Keynes ([1931] 1963, p. 358): "We are suffering, not from the rheumatics of old age, but from the growing-pains of over-rapid changes, from the painfulness of readjustment between one economic period and another. The increase of technical efficiency has been taking place faster than we can deal with the problem of labor absorption; the improvement in the standard of life has been a little too quick. . . . "

As merely a problem of the transition, the downturn can be remedied by the implementation of the appropriate State agendum. However, Keynes's express purpose in this essay is not to treat short-term problems of economic management but "to take wings into the future" and to reveal his new intuitions regarding the course of the long-term evolution of British economy and society (Keynes [1931] 1963, p. 360). He begins by presenting a more detailed stage theory of history, which focuses almost exclusively on capital accumulation as the agent of social transformation. The first stage of history spans the period from 2,000 B.C. to 1,700 A.D. and is characterized by a stagnant standard of life for the average man dwelling in the centers of civilization due "to the remarkable absence of important technical improvements and to the failure of capital to accumulate" (Keynes [1931] 1963, p. 360). Keynes's intuition leads

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him to speculate that, during some epoch before the dawn of recorded history, "there must have been an era of progress and invention comparable to that in which we live today" (Keynes [1930] 1963, p. 361).

Following, then, what we might call the pre-historical and pre-modern eras is the third stage or "modern age." Keynes ([1930] 1963, p. 361) holds that the transition to the modern age was precipitated by "the accumulation of capital which began in the sixteenth century" with the influx of gold and silver from the Americas into Spain. Once begun, the process of capital accumulation begets its own continuous growth through the wondrous power of compound interest. Gone is Keynes's belief, expressed in the *Economic Consequences of the Peace*, that capital accumulation depends on psychologically unstable and irrational motives to save. The link between saving and investment is explicitly severed in the *Treatise* and Keynes is already halfway to the views of the *General Theory* that saving actually impedes the process of capital investment and destroys its fruits. Thus, in the latter work, saving is considered the enemy of social evolution and of the ethical good, to be shown no quarter and hounded unto death polemically.

For now, Keynes ([1931] 1963, p. 361) writes: "From that time [of the influx of the precious metals into Spain] until today the power of accumulation by compound interest, which seems to have been sleeping for many generations, was re-born and renewed its strength. And the power of compound interest over two hundred years is such as to stagger the imagination."

The modern age is also "the great age of science and technical inventions," the beginning of which Keynes ([1931] 1963, p. 363) dates from the sixteenth century and which has been "in full flood" since the start of the nineteenth century. Keynes estimates that a one-hundredfold increase of the capital stock combined with rapid technological advance have worked to raise the contemporary standard of life in Europe and the United States fourfold since the end of the pre-modern era. So rapid has been the advance of labor-saving technology in the decade of the 1920s in Europe, and especially in the United States, that it has unleashed a new economic affliction which Keynes ([1931] 1963, p. 364) labels "technological unemployment." Thus, for the Keynes ([1931] 1963, p. 364) of 1930, the contemporary employment situation is only "a temporary phase of maladjustment" and is, in fact, a welcome harbinger of the impending dawn of the millennium. According to Keynes ([1931] 1963, pp. 364–65), "All this means in the long run [is] *that mankind is solving its economic problem*. I would predict that the standard of life in progressive

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countries one hundred years hence will be between four and eight times as high as it is today."

For support of his assertion that scarcity is a transitory historical stage, rather than a fundamental and categorial precondition of human life and action, Keynes draws on the Marshallian classification of wants. He distinguishes between two classes of wants, which he designates as "absolute" and "relative" respectively. Wants of the second class, which are based on a desire to attain superiority over one's fellows, very well may be insatiable "for the higher the general level, the higher still are they" (Keynes [1931] 1963, p. 365). However, in the case of absolute wants, "a point may soon be reached, much sooner perhaps than we are all of us aware, when these needs are satisfied in the sense that we prefer to devote our further energies to non-economic purposes" (Keynes [1931] 1963, p. 365). With his typical gnosticism, Keynes ([1931] 1963, p. 366) then reveals to his readers that, assuming no significant wars or growth in population, the economic problem will be solved or "in sight of solution" within one hundred years and that, therefore, the economic problem is not "the permanent problem of the human race."

Echoing Marshall, Keynes ([1931] 1963, p. 367) characterizes the "real" and "permanent" problem confronting man as "how to use his freedom from pressing economic cares, how to occupy the leisure, which science and compound interest will have won for him, to live wisely and agreeably and well." In other words, the problem is one of adjusting human nature to the millennium, and, not surprisingly, it is a problem to which Moore's philosophy is the ready-made solution.

The problem stems from the fact that, from its very creation, humanity has been in a death match with scarcity and, thus, has been "expressly evolved by nature" to solve the economic problem. The impending solution of the latter problem therefore deprives humankind "of its traditional purpose." The consequence is that the "ordinary man" will be required to cast aside, within the space of a few decades, inbred habits and instincts that have served him for centuries (Keynes [1931] 1963, p. 366).

Failure to come to grips with this problem will result, according to Keynes ([1931] 1963, p. 366), in a "general 'nervous breakdown,'" quite like the condition afflicting the wives of the well-to-do in the United States and England of Keynes's time. In fact, it is these women who are humanity's vanguard in the millennium. It is they "who have been deprived by their wealth of their traditional tasks and occupations—who cannot find it sufficiently amusing, when deprived of the spur of economic necessity, to cook and clean and mend, yet are quite unable to find anything more amusing" (Keynes [1931]

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1963, p. 367). In general, the wealthy are humanity's "advance guard" in the millennium, "who are spying out the promised land for the rest of us and pitching their camp there," and, for the most part, they have "failed disastrously . . . to solve the problem which has been set them" (Keynes [1931] 1963, p. 368).

Despite the failures of the vanguard, Keynes is confident that right thinking can serve as a guide in the millennial "age of leisure and of abundance," and he maps out the steps that must be taken in this direction. In general, his plan involves abandoning the long-accepted attitudes toward activities and morals that evolved in response to the economic problem and inculcating Moorite attitudes in their stead. In particular, attitudes toward work, money, purposefulness, and futurity must undergo radical transformation.

In the case of work, it is to be recognized as an activity which, in small doses, is necessary to human contentment or will be for ages to come. Keynes ([1931] 1963, p. 369) recommends that the work still to be performed in the millennium be spread very thinly so that everyone might content himself with a fifteen-hour work week carried out in three-hour shifts.

There must also be great changes in the code of morals. This is to be purged of the "pseudo-moral principles" which " have exalted some of the most distasteful of human qualities into the position of the highest virtues" but which were nonetheless necessary to foster the accumulation of capital (Keynes [1931] 1963, p. 269). For example, the desire to possess money, valueless and irrational in itself and finally rendered useless as a means, will be seen for what it is: according to Keynes ([1931] 1963, p. 369), "a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease." The same reappraisal will take place with regard to customs and practices involving the distribution of wealth and income, which while "distasteful and unjust in themselves," are "tremendously useful in promoting the accumulation of capital" (Keynes [1931] 1963, pp. 369–70).

Moreover, for Keynes, the individual's pursuit and accumulation of wealth is only a subspecies of purposive behavior. Such behavior, as Keynes recognizes, implies the logical and temporal separation of means and ends: all action employs means in the present and is aimed at achieving an end in the more or less remote future (Mises 1966, pp. 100–01). The elements of futurity and teleology inherent in purposive action, however, offend Keynes's Moorite notion of the good, involving as they do the sacrifice of immediate and direct experience of timeless, self-contained, and intrinsically valuable

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mental states. As Mises (1966, p. 100) points out, "[f]or contemplative meditation, time is only duration," with no distinction between present and future; it is purposeful action "that provides man with the notion of time and makes him aware of the flux of time. . . . [I]t is not recollection that conveys to man the categories of change and of time, but the will to improve the conditions of his life."

Thus, as Keynes also recognizes, the very notion of present and future is ineluctably bound up with purposiveness. From the insight that action is necessarily aimed at the future, however, Keynes ([1931] 1963, p. 370) incorrectly deduces a non-marginal or absolute preference to postpone present consumption *forever* into the future or, in the terminology of the later *General Theory*, a "propensity to save." This leads him to lash out at the seeming irrationality of purposeful activity:

> For purposiveness means that we are more concerned with the remote future results of our actions than with their own quality or their immediate effects on our own environment. The "purposive" man is always trying to secure a spurious and delusive immortality for his acts by pushing his interest in them forward into time. He does not love his cat but his cat's kittens; nor, in truth, the kittens, but only the kittens' kittens, and so on forward for ever to the end of cat-dom (Keynes ([1931] 1963, p. 370).

If Keynes had fully grasped the time preference theory of interest, he would have been aware that acting man does not demonstrate an *absolute* preference for future satisfactions (which, of course, implies forever postponing consumption in the present) but *discounts* future vis-à-vis present satisfactions. All other things equal, human beings, acting in isolation or on the market, will only save and invest resources in provision for the future, if such investment promises a level of future consumption that exceeds the sacrificed present consumption by an amount that overcomes their subjective time preferences. The rate of interest, then, is the catallactic reflection of the universal phenomenon of time preference.

At this point in time, however, Keynes construes capital as an independently productive factor, coordinate with land and labor and automatically generating an interest return (a view which he was to renounce in the *General Theory*). Keynes thus sees the phenomenon of compound interest, not as a categorial implication of action, but as simply another rationalization for the delusive future orientation of purposive action. For Keynes, interest serves to reinforce and reward an innate or evolved propensity to wealth accumulation present in human beings of the "modern age." This explains Keynes's strange and oblique reference to the Jews in the following terms: "Perhaps it

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is not an accident that the race which did the most to bring the promise of immortality into the heart and essence of our religions has also done the most for the principle of compound interest and particularly loves this most purposive of human institutions" (Keynes [1931] 1963, p. 371).

Once the burden of scarcity and the need for capital accumulation have been eliminated, the human race will at long last be free to return to what Keynes ([1931] 1963, p. 371) calls "some of the most sure and certain principles of religion and traditional virtue" as its guide in the millennium. Keynes ([1931] 1963, pp. 371–72) recites and extols these Moorite virtues, while condemning the vices associated with purposiveness, in terms worthy of the Sermon on the Mount:

> avarice is a vice, . . . the exaction of usury is a misdemeanor, and the love of money is detestable, . . . those walk most truly in the paths of virtue and sane wisdom who take least thought for the morrow. We shall once more value ends above means and prefer the good to the useful. We shall honor those who can teach us how to pluck the hour and the day virtuously and well, the delightful people who are capable of taking direct enjoyment in things, the lilies of the field who toil not, neither do they spin.

But, counsels Keynes ([1931] 1963, p. 372), a century yet must pass before such values can be embraced and, so, "[a]varice and usury and precaution must be our gods a little while longer." Even so, Keynes ([1931] 1963, p. 373) encourages "mild preparations for our destiny" in the form of experiments in "the arts of life" as well as in "the activities of purpose."

The Renunciation of Marshallian Orthodoxy

As the 1930s wore on and the world economic crisis deepened, however, Keynes began to doubt that capitalism as constituted could ever bring about the ripening of the modern age into the millennial. Beset by this growing doubt, Keynes was inspired to rethink the economics of capitalism and the implied State agenda as these were presented in the *Treatise on Money* in 1930. His exhortation—as expressed in his popular writings—to experiment in the "activities of purpose," i.e., in the institutions and organization of the economy, became more insistent.

As his thought evolved during this period, Keynes came increasingly to believe that the sins of "avarice, usury, and precaution" (which, in the language of the *General Theory*, became "liquidity preference, interest payments to the *rentier*, and saving"), not only were evil and had no use in the paradisiacal age of leisure and abundance, but were at the root of the economic instability and

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stagnation of the present age of economic scarcity and therefore must be expunged by the State. It was at this point that Keynes's intuition suggested the extension of the Moorite perspective from personal ethics and social philosophy to technical economics.

In fact, we already see this beginning to occur in the *Treatise*. Here, Keynes breaks the link between saving and investment, theorizing that investment and capital growth can occur without necessitating saving to an equal extent and, conversely, that saving can occur without generating equal investment, an insight which Keynes, under the influence of Dennis Robertson, incorporated into his thought as early as 1926 (Patinkin 1976, pp. 36, 46, 50, 124). However, while Robertson and the early Keynes argued that excess investment and excess saving were the consequences of and equal to bank credit expansion and contraction, respectively, the later Keynes explicitly and emphatically repudiates this view in controversy with Robertson and Hayek (Patinkin 1976, pp. 28, 30–31). From the later perspective of the *Treatise*, Keynes (1973, p. 251) argues that "[s]aving and investment can get out of gear without any change on the part of the banking system from 'neutrality' as defined by Dr. Hayek, merely as a result of the public changing their rate of saving or the entrepreneurs changing their rate of investment, *there being no automatic mechanism in the economic system to keep the two rates equal*" [Emphasis added].

Thus Keynes in the *Treatise* identifies saving-investment disequilibria as arising from within the capitalist economy itself, and therefore necessitating a Burkean State agendum to match decentralized decisions to save and to invest. Moreover, these disequilibria create instabilities in prices and output, causing what Keynes calls "credit cycles." Taking direct aim at the sinful "love of money as a possession," Keynes ([1930] 1958, pp. 2, 347) attributes such disequilibria to the increased "bearishness" of a public, which, in the grip of heightened uncertainty about the future, is suddenly possessed of an increased "propensity to hoard" savings deposits and forego ownership of securities. This irrational behavior drives the long-term rate of interest above its equilibrium level thereby driving down "the value and volume of new investment."

In fact, the *Treatise* was written with the primary purpose of setting out detailed State agenda for "the control of the rate of investment," and, therefore, of capital accumulation and the *pace* of the approach to the millennium. This is consistent with Keynes's statement at the end of "Economic Possibilities for Our Grandchildren" (Keynes [1931] 1963, p. 373) that "[t]he pace at which we can reach our destination of economic bliss will be governed" by, among

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other things, "the rate of accumulation as fixed by the margin between our production and our consumption."

Not surprisingly, as Patinkin (1976, pp. 125–26 6n) has pointed out, the *Treatise* is infected with a "magic-formula mentality." Surely someone who is blessed with knowledge of history's final goal can be presumed to have the formula for reaching that state. Thus, Keynes (1973, p. 354) himself refers to the *Treatise*'s "fundamental equations" of price-level determination as "my secret" to the explanation and, presumably, to the remedy of booms and slumps. The remedy Keynes advocates in the *Treatise* for disequilibrium between saving and investment is bank rate and Treasury bill policy. Especially during a slump, Keynes believed that central bank action designed to lower interest rates and spur investment must be complemented by international central bank cooperation or, if cooperation is either not forthcoming or not successful, supplemented by government borrowing for expenditures on public works (Patinkin 1982, pp. 205–07).

Patinkin (1976, p. 55) characterizes the development of Keynes's technical economic thought between the publication of the *Treatise* and the publication of the *General Theory* as progressing through three stages. These stages can be related to the progressive shattering of Keynes's Marshallian faith, under the impact of the Great Depression, in the efficacy of contemporary capitalism to maintain a rate of capital accumulation sufficiently high to see society through the transition to the millennium within a reasonable period of time, i.e., Keynes's prophesied one hundred years. In the face of his lapsing faith in the Marshallian orthodoxy, Keynes began to formulate a deliberately "heretical" economics which emphasized the Moorite value of radical present orientation in private and governmental spending decisions as the key to restarting and maintaining the engine of capital accumulation on the road to the age of leisure and abundance. Conversely, the new faith sought to "criminalize" saving, particularly the piling up of idle and barren money balances, and the taking of interest as the main impediments to capital accumulation.

In 1930, although he declared that the desire to possess money as an end in itself would be recognized as a "semi-pathological, semi-criminal propensity" in the coming age of abundance and leisure, Keynes did not dissent in the slightest from the orthodox Marshallian economic doctrine that such a propensity was necessary to the achievement of permanent victory over economic scarcity. However, by the time the *General Theory* was published in 1936, the moral crimes of "liquidity preference" and "the propensity to save" stood indicted by Keynes, the Moorite heretic, as the main obstructions on the road to the solution of the economic problem. In explicit opposition to

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Marshall's belief that the constraint on capital accumulation is to be explained by "the preference which the great mass of humanity have for present over deferred gratifications," Keynes ([1936] 1964, p. 242), writing in the *General Theory*, propounded the doctrine that the paucity of accumulated capital "after several millennia of steady individual saving . . . is to be explained . . . neither by the improvident propensities of mankind, nor even by the destruction of war, but by the high liquidity-premiums formerly attaching to the ownership of land and now attaching to money."

Let us now examine the process by which, during the crucial period of 1930-36, Keynes transformed his technical economics by the infusion of Moorite insights. In the first stage of this transformation, (which by Patinkin's account lasted through 1931), Keynes was engaged in what Patinkin (1976, p. 55), borrowing Moggridge's terminology, calls the "arguing out of the *Treatise*." During this time Keynes continued to adhere to the technical economics and policy prescriptions of the *Treatise* and, on the broadly philosophical side, to his earlier belief that current institutional arrangements would continue to produce steady progress to the millennium. Nonetheless, toward the end of this period, Keynes waxed increasingly critical of the role of saving in perpetuating Britain's slump and was perfervid in his advocacy of a massive increase in public and private spending as the cure for the depression.

In an article published in January 1931, Keynes ([1931] 1963, pp. 152–54) declaimed against increased thrift and in favor of unleashing "the improvident propensities" of both consumers and government as a remedy for depression:

> The best guess I can make is whenever you save five shillings, you put a man out of work for a day. Your saving that five shillings adds to unemployment to the extent of one man for one day—and so on in proportion. On the other hand, whenever you buy goods you increase employment—though they must be British, home-produced goods if you are to increase employment in this country. . . .
>
> Therefore, oh patriotic housewives, sally out tomorrow early into the streets and go to the wonderful sales which are everywhere advertised. . . . Lay in a stock of household linen, of sheets and blankets to satisfy all your needs. And have the added joy that you are increasing employment, adding to the wealth of the country because you are setting on foot useful activities. . . .
>
> For what we need now is not to button up our waistcoats tight, but to be in a mood of expansion, of activity—to do things, to buy things, to make things. . . . Now is the time for municipalities to be busy and active with all kinds of sensible improvements. . . .
>
> Nationally, too, I should like to see schemes of greatness and

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> magnificence designed and carried through. . . . For example, why not pull down the whole of South London from Westminster to Greenwich, and make a good job of it—housing on that convenient area near to their work a much greater population than at present, in far better buildings with all the conveniences of modern life, yet at the same time providing hundreds of acres of squares and avenues, parks and public spaces. . . . Would that employ men? Why, of course it would.

The great weight placed on current spending in the foregoing passage and the lack of reference to techniques of monetary policy in the balance of the article from which it is extracted represents a departure, at least in emphasis, from the agenda Keynes elaborated in the *Treatise* for righting a capitalist economy in a slump. Also, in this passage the view is clearly expressed—which is at the core of the technical economics of the *General Theory* and is not to be found in the *Treatise*—that, in depression conditions, spending *per se* is productive of income.

Despite all this, however, Keynes ([1931] 1963, pp. 155–56), at the end of the article, is at pains to demonstrate that labor productivity and national income are continuing to grow at a healthy clip. He concludes with a stirring reaffirmation of his Marshallian belief that the slump is evidence of an ongoing transition to the millennium:

> Be confident, therefore, that we are suffering from the growing pains of youth, not from the rheumatics of old age. We are failing to make full use of our opportunities, failing to find an outlet for the great increase in our productive powers and our productive energy. Therefore we must not draw in our horns; we must push them out. Activity and boldness and enterprise, both individually and nationally, must be the cure. (Keynes [1931] 1963, p. 156)

In a series of lectures presented in June 1931 and published the same year, it is evident that Keynes (1973, pp. 343–67) is still analyzing the depression from the philosophical perspective and using the theoretical apparatus of the *Treatise*. Thus, he draws attention to the worldwide investment boom which occurred in the lustrum 1925 to 1929, speculating that "[a] very few more quinquennia of equal activity might, indeed, have brought us near to the economic Eldorado where all our reasonable economic needs would be satisfied" (Keynes 1973, p. 348).

In a polemical swipe at supporters of the Mises-Hayek theory of the business cycle, represented in Great Britain by Lionel Robbins and other economists associated with the London School of Economics, Keynes (1973, p. 349) chastises those "austere and puritanical souls" who hold that the investment boom was inflationary and

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unsound and, therefore, requires a period of liquidation. For Keynes, any acquiescence in a period of "prolonged liquidation" of previous capital investments postpones or even reverses progress toward the millennium. The thing is to get the aborted investment boom restarted as quickly as possible. What is required, according to the "magic formula" of the *Treatise*, is to restore business confidence and profits via "a drastic fall in the long-term rate of interest" (Keynes 1973, p. 359).

Striking a Burkean note, Keynes (1973, p. 365) emphasizes that it is "the prime object of financial statesmanship" to insure that the long-term rate of interest is properly adjusted to "the technical possibilities of [the] age," so as to produce equality between the volume of savings and the demand for new capital. Failure to achieve such equality will not only produce cyclical fluctuations but runs the risk of throwing society off its long-run course to economic bliss.

Keynes (1973, p. 369) concludes:

> Thus we need to pay constant attention to the long-term rate of interest for fear that our vast resources may be running to waste through a failure to direct our savings into constructive uses and that this running to waste may interfere with that beneficent operation of compound interest which should, if everything was proceeding smoothly in a well-governed society, lead us within a few generations to the complete abolition of economic want.

It is thus clear that Keynes's vision of capitalism during the period of "arguing out the *Treatise*" was still a fundamentally Marshallian one of a self-steering vehicle carrying humanity forward along the road to the millennium. Although this vehicle proceeded unsteadily in fits and starts, Keynes did not doubt that its direction on balance was forward and that it would eventually reach its destination. Extending the metaphor, what the vehicle lacked, according to Keynes, was not so much a pilot as a governor to steady and maximize its rate of speed in order to expedite its journey. In particular, saving and investment rates needed to be governed and equilibrated at the margin by means of continual political manipulations of the long-term interest rate.

As the world and Britain's economic crisis deepened, however, Keynes began to doubt the accuracy of this vision. The vehicle had stopped dead in its tracks and was even threatening to reverse its course. Capitalism had ceased to deliver the goods, now or in the future, as both consumption and investment shrank to drastically low levels. By 1932, Keynes entered into what Patinkin (1976, pp. 55, 61) calls "the formative stage of the *General Theory*." It was during this period that Keynes consciously set out to overturn the Marshallian

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orthodoxy and found a self-proclaimed heretical religion based on Moorite ethics.

In an unpublished two-page note, probably written in 1932, Keynes (1973, pp. 406–07) confesses his apostasy, at the same time revealing the central tenets of his new faith. First, he denies that the capitalist economy embodies "natural forces" which operate to restore output to its "optimum level" whenever it is disturbed. Second, Keynes) singles out "the strength of the forces in the community which tend toward saving" as the factor which causes real output to achieve an equilibrium at a level below the optimum. Contrary to the "orthodox theory," which emphasized "the importance of saving as the means of making a community wealthy," Keynes stresses the primacy of investment. He also denounces orthodox policy prescriptions, revealing that "it now seems to me that the economists, in their devotion to a theory of self-adjusting equilibrium, have been, on the whole, wrong in their practical advice and that the instincts of practical men have been, on the whole, sounder."

Keynes (1973, p. 407) also upholds certain policies favored by "uninstructed public opinion and the common sense of the business world" as "tending towards optimum output." These include: "Mercantilist and protectionist policies," which tend to foster foreign investment by improving the balance of trade; "Anti-usury laws and principles and cheap money policies," which reduce the rate of interest thereby spurring domestic investment; and "Expenditure as a thing in itself 'good for trade'" since it decreases saving in excess of investment. These "popular policies" are economically justified, declares, because, under modern capitalism, "it is a normal thing . . . for output to be below the optimum level."

Keynes concludes with the suggestion, which was to become a central insight of the *General Theory*, that an increment in investment will generate the saving necessary to finance itself. Writes Keynes (1973, p. 407): "Thus so far from its being true that, if we look after saving, output and investment will look after themselves, the opposite is more nearly true, namely that, if we look after investment, output and saving will look after themselves. For it is frequently the case in practice that a deliberate increase in saving will diminish investment and hence output . . . while a deliberate increase in investment will increase output and hence saving."

Now, it is true that in 1932, Keynes had not yet elaborated the theoretical structure to properly house these insights. As Patinkin (1973, p. 72) says of this among, other fragments of Keynes's writings in 1932, "[t]he voice is that of the *General Theory*: but the analytical framework is still largely that of the *Treatise*." And, it might be added,

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the voice is clearly calling for economic salvation through renunciation of the sin of saving. For Keynes, at long last, the precepts of economic rationality have become one with those of virtuous behavior. Virtue receives its reward in this age as well as in the next, after all; and one can have one's economic pie in the millennium and still consume it in the here and now.

In 1933, Keynes published an article entitled "National Self-Sufficiency," whose significance has been downplayed by his followers. Generally, if it is alluded to at all, it is treated as a temporary deviation by Keynes from his internationalist principles in a desperate and ill-advised search for an expedient to alleviate domestic unemployment (Harrod 1951, p. 446; Harris 1955, pp. 186–87; Harris ([1947] 1973, pp. 319–22). One of the few to grasp its true import was the neglected international monetary economist Michael A. Heilperin (1962, pp. 111, 116), who referred to the article "for all its brevity, as one of Keynes's most significant writings" and as representing "far more than a passing mood."

Indeed, the article represents much more than Keynes's profession of disbelief—spewed forth in desperation and soon to be retracted—in the classical arguments in favor of free trade and the international division of labor. When considered in the context of the development of his *Weltanschauung*, it is nothing short of Keynes's public declaration of a loss of faith in the ability of capitalism ever to solve the problem of scarcity and deliver society to the promised land. Accordingly, the article also sends forth a clarion call for experimentation with alternative economic institutions and arrangements.

Until this point, Keynes had been unwavering in his view that, despite its intrinsic viciousness, capitalism was tolerable and even indispensable as the means to a future age of abundance in which virtue could be cultivated in comfort and leisure. In this article, Keynes signals a radical departure from this view, arguing now that capitalism is intolerable because it is unable to deliver humanity from scarcity and that it is precisely its lapses from virtue that prevent it from doing so.

Thus Keynes (1933, pp. 760–61) declares that "[t]he decadent international but individualistic capitalism . . . is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous—and it doesn't deliver the goods. In short, we dislike it, and we are beginning to despise it." However, Keynes does confess to perplexity about what to put in its place, while noting that "the world is embarking on a variety of politico-economic experiments." Russia, Germany, Italy and other countries are or will be seeking "after new

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economic gods." Keynes (1933, p. 761) expects "many mistakes" to be made in these bold experiments in Bolshevism, Nazism, and Fascism, but "[n]o one can tell which of the new systems will prove itself best."

As Heilperin (1962, p. 114 30n) has pertinently remarked on this passage, "[t]he fact that the 'new economic gods' of Russia, Italy and Germany were totalitarian despotic gods, destructive of human dignity and human rights did not, it seems, appear worthy of note. They were experimenting—that was the wonderful thing about it!" Heilperin's judgment on the implications of Keynes's unbounded zeal for politico-economic experimentation is certainly borne out by Keynes's own revelation in the article that he is "one whose heart is friendly and sympathetic to the desperate experiments of the contemporary world, who wishes them well and would like them to succeed, who has his own experiments in view, and who in the last resort prefers anything on earth to what the financial reports are wont to call 'the best opinion in Wall Street'" (Keynes 1933, p. 766).

Keynes's almost exclusive concern at this point is that capitalism be gotten rid of, so that the world will be free to experiment. What replaces it depends on one's "own fancy." In Keynes's millennialist terminology, "[n]ot believing that we are saved already, we each should like to have a try at working out our own salvation. We do not wish, therefore, to be at the mercy of world forces working out, or trying to work out, some uniform equilibrium according to the ideal principles, if they can be called such, of *laissez-faire* capitalism." Accordingly, Keynes proclaims the dawning of a "transitional, experimental phase" during which "we all need to be as free as possible of interference from economic changes elsewhere, in order to make our own favorite experiments toward the ideal social republic of the future."

While Keynes's "favorite experiment," at least in its economic aspect, must await full elaboration in the *General Theory*, he does offer suggestive hints in this article. In particular, although he favors "retaining as much private judgment and initiative and enterprise as possible," Keynes (1933, p. 762) reveals that he has "become convinced that the retention of the structure of private enterprise is incompatible with that degree of material well-being to which our technical advancement entitles us, unless the rate of interest falls to a much lower figure than is likely to come about by natural forces operating on the old lines. Indeed, the transformation of society, which I preferably envision, may require a reduction in the rate of interest towards vanishing point within the next thirty years." Economic internationalism, by which Keynes means not only the free

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movement of goods but especially a structure of interest rates determined on a globally integrated capital market, is thus emphatically rejected by Keynes (1933, p. 763), because it "may condemn my own country for a generation to come to a much lower degree of material prosperity than could be attained under a different system."

The conventional view, therefore, is doubly wrong in contending that, for Keynes, economic autarky represented a temporary expedient for palliating a desperate employment situation in Great Britain. To the contrary, Keynes's overriding concern, as expressed in the last paragraph, is not with "full employment" *per se*, but with what he later refers to as "full investment"; and "greater national self-sufficiency and a planned domestic economy" (Keynes 1933, p. 767) is proposed as a necessary and *permanent* framework for an economic experiment—here only alluded to but fully developed in the *General Theory* (Keynes [1936] 1964, especially chapters 16 and 24)—in which the interest rate is reduced to zero and underinvestment and artificial capital scarcity forever banished from the British Isles.

The long-accepted belief that, in writing the *General Theory*, Keynes was seeking to provide a blueprint for "saving capitalism" from its own instability is thus anachronistic at best. In fact, while this was indeed Keynes's objective in contriving the "magic formulas" of the *Treatise*, he abandoned it after 1931 and certainly by the time he came to plump for indiscriminate politico-economic experimentation and national self-sufficiency in 1933. With respect to capitalism, then, the Keynes of the *General Theory* is not a savior in any sense but a vengeful angel come at last to destroy what is immoral and unaesthetic because it has finally proven useless.

Near the end of his article on "National Self-Sufficiency," as if to accentuate the radical and irreversible nature of the "reorientation" of his mind, Keynes (1933, pp. 763–65) undertakes what can only be characterized as a diatribe against capitalist society and culture which is as remarkable for its candor as it is for its unrestrained vituperativeness. In this, Keynes recognizes and seizes upon economic calculation in the form of financial accounting as the intellectual foundation of market economy and the calculating mind as the consummate product of social evolution under capitalism. Thus, he contends that consistently judging action by the criterion of "the financial results" transformed the conduct of life in the nineteenth century "into a sort of parody of an accountant's nightmare" (Keynes 1933, p. 763).

Keynes rails against economic calculation because it represents an artificial constraint on the current use of resources, which is imposed by the illusory notion of futurity inherent in purposive action

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and, thereby, obstructs the living of a bountiful and cultured life in the present. Thus Keynes (1933, pp. 763–64) declares that:

> Instead of using their vastly increased material and technical resources to build a wonder city, the men of the nineteenth century built slums; and they thought it right and advisable to build slums because slums, on the test of private enterprise, "paid," whereas the wonder city would, they thought, have been an act of foolish extravagance, which would, in the imbecile idiom of the financial fashion, have "mortgaged the future"—though how the construction today of great and glorious works can impoverish the future, no man can see until his mind is beset by false analogies from an irrelevant accountancy. . . . For the minds of this generation are still so beclouded by bogus calculations that they distrust conclusions which should be obvious. . . . We have to remain poor because it does not "pay" to be rich. We have to live in "hovels," not because we cannot build palaces but because we cannot "afford" them.

But once one has "reoriented" his mind to an economics imbued by the ethical verities, as Keynes has already done by this time, he is enabled to pierce through the intellectual fog created by economic calculation and perceive clearly that the active pursuit of virtues and values in the present calls forth and multiplies the bounty of resources necessary to their attainment. In the technical language of the *General Theory*, financing considerations are never a constraint on private (or public) investment, because investment creates the saving needed to finance it and raises present income and consumption into the bargain. As Keynes (1933, p. 764) expresses it here: "If I had the power to-day, I should most deliberately set out to endow our capital cities with all the appurtenances of art and civilization on the highest standards of which the citizens of each were individually capable, convinced of what I could create, I could afford. . . ."

Keynes is especially averse to the "rule of self-destructive financial calculation," when it justifies, for example, through the promotion of free trade, the eradication of activities whose unquantifiable intrinsic value can find no entry into such calculation. Writes Keynes (1933, p. 764): "we have until recently conceived it a moral duty to ruin the tillers of the soil and to destroy the age-long human traditions attendant on husbandry, if we could get a loaf of bread thereby a tenth of a penny cheaper." Such present sacrifices in the name of economic calculation, "this Moloch and Mammon in one," according to Keynes (1933, pp. 764–65), have been carried out with equanimity because of a delusive concern for the future, "for we faithfully believed that the worship of these monsters would overcome the evil of poverty and lead the next generation safely

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and comfortably, on the back of compound interest, into economic peace."

For Keynes (1933, p. 765), the tragedy of adherence to the old doctrines does not lie in the absolute reduction of the British "standard of life," which, even in 1933, is at a higher level than ever before. It lies mainly in the fact that sacrifices of ethical values and modes of living have been made and made wholly in vain, because capitalism has been unable "to exploit to the utmost the possibilities for economic wealth afforded by the progress of . . . technique." The implication, of course, is the principle of the multiplier by which it is held that, under the normal operation of capitalism, the present "standard of life" need never be diminished and is indeed enhanced by an act of investment, which is aimed at fructifying the future and advancing society closer to the millennium.

Keynes (1933, p. 765) is thus able to conclude that "once we allow ourselves to be disobedient to the test of an accountant's profit, we have begun to change our civilization." This, of course, is tantamount to the call for the progressive socialization of investment, since the State is the only organization, with its almost unlimited power to appropriate scarce resources via taxation and monetary inflation, that is unconstrained by the criterion of economic calculation. This is realized by Keynes (1933, p. 765), who writes that "[i]t is the state, rather than the individual, which needs to change its criterion. . . . Now if the functions and purposes of the state are to be thus enlarged, the decisions as to what, broadly speaking, shall be produced within the nation and what shall be exchanged with abroad, must stand high among the objects of policy."

Keynes's article on "National Self-Sufficiency" thus presents the core of what Patinkin (1976, p. 95) labels the "antivision" of the *General Theory*. This is the "rejection of the traditional view that there existed in the capitalist world an automatic, self-adjusting mechanism that could be relied upon to maintain an acceptable state of employment" and, I would add, investment. In fact, for Keynes, the attainment of full-employment levels of income and consumption is the consequence of and the present reward for expediting progress to the future state of bliss by deliberately optimizing the rate of investment.

In a radio address on "Poverty in Plenty: Is the Economic System Self-Adjusting?" delivered in 1934, Keynes (1973, p. 488) explicitly ranges himself with "the heretics" who would "demolish the forces of nineteenth-century orthodoxy." Bringing his antivision to bear, Keynes argues that the orthodox or "self-adjusting" school assumes that "the rate of interest adjusts itself more or less automatically, so

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as to encourage just the right amount of production of capital goods to keep our incomes at the maximum level which our energies and our organization and our knowledge of how to produce efficiently are capable of providing. This is, however, pure assumption."

Thus it is the failure of capitalism to provide the optimum level of investment spending, or, what is the same thing for Keynes, the maximum rate of progress toward the millennium (given prevailing consumption habits) which is the root cause of its technical inadequacy. For Keynes (1973, p. 491) the solution is straightforward and closed to all doubt: "The right course is to get rid of the scarcity of capital goods—which will rid us at the same time of most of the evils of capitalism—whilst also moving in the direction of increasing the share of income falling to those whose economic welfare will gain most by their having the chance to consume more." Of course, the solution will not emerge spontaneously from the operation of the capitalist system and must be imposed from without by the State, because "[t]he system is not self-adjusting, and, without purposive direction, it is incapable of translating our actual poverty into our potential plenty."

The positive vision of the *General Theory*, then, emerges out of Keynes's deliberate use of Moorite philosophical insights and doctrines to revolutionize the analytical apparatus of Marshallian economic theory in order to provide an explanation of the capitalist economic process that elucidates the causes and consequences of its failure to achieve adjustment at an employment- and investment-maximizing level of output. According to research by Patinkin (1976, pp. 55, 73), the analytical structure of the *General Theory* was completed by mid-1934, and, in the third and final stage of its preparation lasting through 1935, Keynes was engaged in eliciting detailed criticisms of the galley proofs of the book.

As identified by Keynes himself (Patinkin 1976, p. 66), the analytical components the development of which mark entry into the third stage of transition to the *General Theory* consist in the theory of effective demand, the theory of liquidity preference, and the concept of the marginal efficiency of capital. To these three, I would add the generally overlooked scarcity theory of capital, which Keynes adumbrated in the *General Theory* only partly in response to Hayek's stinging criticism of the *Treatise on Money* for lacking reference to a "clear and definite theory of capital" (Hayek 1931, p. 278). Taken together, these four components form a powerful analytical apparatus that permits Keynes to weave a vision in which the sins of futurity and calculation—which characterize purposive action

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under capitalism—prove also to be irrational, self-defeating, and socially retrogressive. In particular, according to Keynes, attempts by individuals to make monetary and financial provision for the future cause humanity to be less well-provided for in the present and the future.

The *General Theory* as Millennialist Economics

Let me broadly indicate the millennialist ethical orientation of the technical economic analysis of the *General Theory*.

The theory of effective demand transmutes Keynes's Moorite emphasis on present activities and states of being from a recipe for individual salvation into the true path to the social millennium. Thus, according to Keynes, present employment and income is determined strictly by effective demand which, with the technical conditions of production assumed constant, depends solely upon aggregate spending for consumption and investment activities. While it is evident that consumption is a present activity, investment, as defined by Keynes ([1936] 1964, pp. 62, 104), denotes "the current addition to the value of the capital equipment which has resulted from the productive activity of the period" and therefore involves "present provision for future consumption."

Saving, on the other hand, is defined not in terms of activity but as the passive "residual or margin" between aggregate income and consumption (Keynes [1936] 1964, p. 64). As such, saving in the aggregate cannot be determined independently of the set of decisions relating to consumption and investment (Keynes [1936] 1964, p. 65). In the words of Abba Lerner (1983, p. 394): "With S thus almost completely sterilized (as nothing but the conceptual arithmetic difference between actual income and actual consumption) it became easier to concentrate on analyzing only the actual constituents of income and sources of employment, C and I."

With consumption rigidly determined by the propensity to consume—according to Keynes ([1936] 1964, pp. 96–97), a "fairly stable function" and one of the "more permanent psychological propensities"—investment spending becomes the sole factor determining levels of present as well as of future income and consumption. Hence "employment can only increase *pari passu* with an increase in investment; unless, indeed there is a change in the propensity to consume" (Keynes [1936] 1964, p. 98). Nor does an increase in investment require an antecedent increase in saving because, according to "the fundamental psychological law" governing the marginal propensity to consume, an increment to social income always calls forth a positive but less than

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equal increment to consumption. Thus, as income increase, it induces an automatic increase in saving in the form of an expansion of the absolute size of the gap between income and consumption. The multiplier sums up the process by which, with a given marginal propensity to consume, an increase of investment results in a rise in the level of income sufficient to generate the additional saving necessary to finance itself.

From Keynes's ethical standpoint, the multiplier apparatus is a masterstroke because it permits him to argue that investment promotes higher standards of income and consumption in the present as well as in the future. The all-important growth in society's capital stock is no longer dependent on the semi-pathological, semi-criminal, and, in any event, unethical propensity to abstain from present enjoyments in order to provide for a chimerical and ever-receding future. The ethical maxim of the Sermon on the Mount is thus transformed into the eminently practicable policy prescription of rational economics: those who would be well cared for, in the present and in the future, are those who do not trouble themselves overmuch about provision for the future.

But Keynes is not satisfied merely with demonstrating that individual efforts to provide for the future by financial accumulation are superfluous to the process by which social income and capital are created; he seeks to portray private saving as self-defeating and socially destructive. Here, again, the concepts of effective demand and the multiplier are ready at hand. Any attempt by an individual to increase saving by accelerating the rate at which he "pile[s] up claims to enjoyment which he does not intend to exercise at any definite time" (Keynes [1936] 1964, p. 131), *ipso facto*, lowers the propensity to consume and causes a slackening of effective demand. The result is a destruction of social income whose size is a determinate multiple of the original reduction in consumption.

However, the social ravages of vicious and irrational precaution do not end with reductions in the current income level; the greater enormity lies in its retardation of the growth of the capital stock, resulting from the circumstance that estimates of the prospective yield rate or marginal efficiency of capital partly depend on "the strength of the existing consumers' demand for goods that require for their efficient production a relatively larger assistance from capital" (Keynes [1936] 1964, p. 147). For Keynes ([1936] 1964, p. 106), therefore, "every weakening in the propensity to consume regarded as a permanent habit must weaken the demand for capital as well as the demand for consumption." Thus, a decline in investment due to a weakening propensity to consume reduces

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potential future income and living standards at the same time that it aggravates the declines in current levels of effective demand, income, and consumption.

The ultimate and cruel irony, of course, is that the individual's attempt to increase saving is incapable of generating a realized increase of saving in the aggregate and, in fact, serves to reduce aggregate realized saving, since the margin between income and consumption, as determined by the marginal propensity to consume, necessarily narrows as the level of income decreases. As Keynes ([1936] 1964, p. 65) puts it, "A decision to consume or not to consume truly lies within the power of the individual; so does a decision to invest or not to invest." But aggregate saving is merely one of the "*results* of the free choices of individuals whether or not to consume and whether or not to invest. . . ."

Based on his economic analysis of saving as a self-frustrating and socially deleterious activity, Keynes ([1936] 1964, p. 161) contemplates, as "the only radical cure" for economic crises, that saving be outlawed, that is, that the individual be allowed "no choice" between spending his income on consumption or investment in a "specific capital asset" and saving it in the form of cash hoards or debt purchases. As we shall see, however, Keynes ultimately opts for an alternative set of policies involving the socialization of investment and the euthanasia of the rentier via the reduction of the rate of interest to zero.

This brings us to the marginal efficiency of capital (MEC), which Keynes defines as the prospective rate of return on an increment of monetary investment in the current production of capital goods. For Keynes ([1936] 1964, p. 145), the MEC schedule "is of fundamental importance because it is mainly through this factor (much more than through the rate of interest) that the expectation of the future influences the present." In this passage, the parenthetical remark about the rate of interest underscores Keynes's determination to maintain a rigid analytical distinction between the concepts of the MEC and the rate of interest. Indeed, Keynes ([1936] 1964, pp. 192–93) devotes a special excursus to refuting those Austrian-Wicksellian interest theorists, such as Mises, Hayek, and the early Alvin Hansen, who identify the basic rate of interest with the rate of price differentials between the products of successive stages of the structure of production. These writers, as well as Keynes of the *Treatise* (Keynes [1936] 1964, pp. 173–74), stand accused of "confusing the marginal efficiency of capital with the rate of interest."

The apparent eagerness with which Keynes seeks to disentangle the two concepts can be explained by their different standings in terms of his ethical thought. The MEC represents a return to a

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current and productive activity, investment, which is legitimately, even nobly, future-oriented. In Keynes's words, "[t]he social object of skilled investment should be to defeat the dark forces of time and ignorance which envelope our future" (Keynes [1936] 1964, p. 155). The rate of interest, in contrast, is a sop to avarice, a "bribe" paid to the nonproductive saver to induce him to part with liquidity, an irrational and nugatory provision for the future.

For Keynes, the all-important task of estimating the prospective rate of return on newly-produced capital equipment is apt to be badly done under capitalism, because open markets and monetary calculation tend to promote irrational expectations of the more remote future. Keynes's argument runs briefly as follows: The knowledge which governs our expectations of the outcome of a long-term investment rests on an extremely precarious basis at best and "is usually very slight and often negligible" (Keynes [1936] 1964, p. 149). Thus, were it not for the fact that human beings take direct pleasure in the riskiness and activity of constructing factories and farms, not much investment would be undertaken "merely as a result of cold calculation" (Keynes [1936] 1964, p. 150). However, under modern capitalism, it is precisely considerations of cold calculation which predominate in investment decisions, because the irrational striving for liquidity has led to the emergence of the stock exchange, an organized market on which investments may be resold and revalued on a daily or even hourly basis.

The result is that most investments come to be "governed by the average expectation of those who deal on the stock exchange as revealed in the price of shares, rather than by the genuine expectations of the professional entrepreneur." Hence, for example, if an existing investment can be had on the stock market at a purchase price below the cost of constructing a new investment of a similar type, this class of investment will be discouraged regardless of its prospective yield. Moreover, the average investor, because his knowledge of the factors governing the prospective yield of the various investment opportunities is virtually nil, bases his decisions on an "arbitrary convention," according to which it is assumed that the existing market valuation of the investment reflects the existing knowledge of the facts which determine its yield and is therefore "uniquely correct" (Keynes [1936] 1964, pp. 152–53). A change in the investment's market value will only occur, therefore, as a result of the (presumably slow and orderly) revision of knowledge as new and relevant facts come to light.

However, such "conventional valuation," in actuality, is not based on genuine, if incomplete, knowledge of the future laboriously accumulated by the experts, but on the "state of confidence" of the mass

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of ignorant investors, which reflects their vague, uninformed, and mercurial doubts, fears, and hopes. Any change in the state of confidence, whether or not in reaction to events reasonably expected to effect long-term investment prospects, brings about a dissolution of the existing conventional valuation and the emergence of a new one. As a consequence, investment markets are inherently volatile and, therefore, divert "the energies and skill of the professional investor and speculator" from attempting to forecast the long-term prospective yield of an investment to contriving to beat the mass of investors in foreseeing and profiting from short-term changes in the conventional basis of valuing stocks (Keynes [1936] 1964, p. 154).

For Keynes ([1936] 1964, p. 153), then, it is ultimately perfidious calculation and irrational convention that account for the "problem of securing sufficient investment." As noted above, both calculation and convention represent serious departures from the ethical code Keynes supposes will prevail in the millennium. The absorption of one's skill and energy in the service of monetary calculation is the very negation of the Moorite notion of the ideal life as the enjoyment of a sequence of good states of mind. The reason is that money, as Keynes ([1931] 1963, p. 356) characterized it, is "the grand substitute motive, the perfect *Ersatz*, the anodyne for those who, in fact, want nothing at all."

Regarding the ethics of relying upon convention as a guide to action in the face of an uncertain future, which was a position espoused by Moore himself, the theory of probability propounded by Keynes in the *Treatise on Probability* implies that such a reliance is irrational, and therefore counterproductive, as a means to attaining the good. As pointed out above, in Keynes's approach to probability, a probability exists in favor of an action as long as the balance of existing evidence, however slight or precarious such evidence is, suggests that it is the most productive of desirable results. Applied to the case of a long-term investment, therefore, although knowledge of the factors affecting the success of its outcome is bound to be precarious, the probability of its success can always be rationally determined as an ordinal ranking in a hierarchy of alternative investment projects.[1] Even where evidence concerning the long-term results of alternative actions or investments is completely absent, as is

[1]The reference to ordinal ranking of probabilities in this case illustrates Keynes's skepticism toward cardinal estimates of probability which is based on his general reluctance to conceive the theory of probability as synonymous with the theory of statistical frequency (Keynes [1921] 1962, esp. chap. 8). I am indebted to an anonymous referee for raising this point.

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sometimes bound to be the case, if there is evidence that one will yield greater advantages in the near future than the others, then, according to Keynes ([1921] 1962, p. 310), "by what seems a legitimate application of the Principle of Indifference we may suppose that there is a probability in favor of the former action."

Keynes's opposition to the conventional valuation of investments alleged to occur in the stock market therefore derives ultimately from a deep-seated ethical belief that, in its recourse to convention, humanity abandons rationality and succumbs to "the dark forces of time and ignorance." In organized investment markets, the abandonment of rationality is reflected in the fact that, since conventional valuation is unrelated to long-term yield considerations and rests on no objective foundation at all, continual and wholesale fluctuations in the state of confidence of investors result from random events. These fluctuations provide lucrative opportunities for "speculation," which divert the professional investors away from the activity of "enterprise" or the task of reasonable estimation of long-term yield prospects. The consequence of such recurrent bouts of overoptimism followed by crises of confidence is the collapse in the MEC, which precipitates the dreaded trade cycle (Keynes [1936] 1964, pp. 315–16).

The existence of the trade cycle thus bespeaks a moral as well as an economic failing of financial capitalism, since it is attributable to "the uncontrollable and disobedient psychology of the business world" (Keynes [1936] 1964, p. 317). Regarding the activity of speculation, which feeds on and profits from such "disobedience"—presumably, to the conclusions of his laboriously elaborated probability theory—Keynes ([1936] 1964, p. 359) draws an explicit connection between its degraded moral quality and its pernicious social consequences: "When the capital development of a country becomes a byproduct of the activities of a casino, the job is likely to be ill-done."

By extending the nexus of monetary calculation to include second-hand investments, organized financial markets thus promote the sins of convention and speculation and suppress capital accumulation. These markets further dampen the rate of investment by increasing its risk. By facilitating the differentiation of the saver-lender from the entrepreneur-borrower, the existence of financial markets requires that, before it may be undertaken, a risky investment promise a return that is sufficient to yield, in addition to the pure rate of interest plus a premium for the borrower's or entrepreneur's risk, compensation for "lender's risk." Unlike the entrepreneurial risk premium, the premium accounting for lender's risk is not "a real social cost" which may be diminished by increased skill in forecasting,

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but "is a pure addition to the cost of investment which would not exist if the borrower and lender were the same person" (Keynes [1936] 1964, p. 144). Moreover, the lender's risk component includes and duplicates a part of the entrepreneur's risk component, because the lender as well as the borrower require a greater premium before committing funds to riskier investments (Keynes [1936] 1964, p. 145).

Keynes ([1936] 1964, p. 164) sees only two remedies for the distorted and volatile MEC schedule and the continually fluctuating and, on average, chronically insufficient level of investment which result from convention, speculation, and the unnecessary and wasteful duplication of risk. The first involves the implementation of a monetary policy designed to manage interest rates in such a way as to elicit continuously the "appropriate volume of investment." But Keynes confesses skepticism toward this alternative. The second, and Keynes's preferred remedy, is to extirpate the root cause of the problem by forthrightly abolishing markets and monetary calculation for investment, i.e., by socializing investment. Writes Keynes ([1936] 1964, p. 164):

> I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency of different types of capital . . . will be too great to be offset by any practicable changes in the rate of interest.

Given his analysis of the MEC, Keynes ([1936] 1964, p. 378) must be taken very seriously when he concludes that "a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment." This is in contrast to the conventional view, as expressed, for example, by Alvin Hansen (1953, pp. 215–16), which portrays Keynes as advocating short-run fiscal fine-tuning, at the same time discounting lengthy discussions of socialization of investment and the attainment of capital saturation as examples of Keynes allowing "his fancy to roam in an irresponsible manner," "flying his kite," and engaging in "fascinating flights of fancy."

Indeed, it has been definitively established by Meltzer (1988, p. 182), that in the *General Theory* "Keynes's main policy recommendation is for public direction of investment" and "Keynes believed that his main recommendations were policy implications drawn from his theory." Moreover, as Meltzer (1988, p. 295) also shows, Keynes did not originate the basic concept of fiscal fine-tuning or functional finance but learned it from Abba Lerner. After initially rejecting Lerner's ideas, Keynes intellectually accepted and praised them, but

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never gave any indication that "he accepted functional finance as a basis for policy." Accordingly, in his wartime memos on post-war reconstruction, Keynes "favored policies to stabilize investment and opposed policies to increase consumption on grounds . . . [that] income can be raised permanently by increasing and stabilizing investment" (Meltzer 1988, p. 186).

We now turn to the liquidity preference theory of interest, which may be characterized as the keystone of Keynes's analytical structure. With the interest rate determined solely by the interaction of the liquidity preference function and the quantity of money, rather than by the supply and demand for saving as in the classical theory, the progressive social force of capital accumulation is, at long last, rendered logically and wholly independent of the sin of saving. In the process, the activity of saving is thoroughly criminalized and deprived of its last shred of redeeming social advantage. No longer is an increase in the rate of saving seen as operating to lower interest rates and thereby to induce the additional spending on investment necessary to offset the negative effect on income of the concomitant decline in the rate of consumption expenditure. To the contrary, the attempted allocation of savings to the accumulation of additional cash balances to satisfy heightened preferences for liquidity actually *raises* the interest rate and reduces investment.

In a nutshell, the theory of liquidity preference tells the story of how the interest rate develops as a purely monetary phenomenon, which is rooted in avarice and precaution and determined on a superfluous market ruled by convention and speculation. Once determined, the interest rate confronts an irrationally determined MEC in an arbitrary monetary calculation that serves only to limit investment and to burden society with an artificial scarcity of capital goods.

In explicating his theory, Keynes begins by bifurcating the decisionmaking process which expresses the individual's "psychological time preferences." In the initial stage of the process, the propensity to consume determines what proportion of his current income the individual will consume and what proportion "he will reserve in *some* form of command over future consumption." Once this decision has been made, the individual's liquidity preference dictates how much of his current stock of savings, which includes savings accumulated from past income flows, he holds in the form of money, which yields "immediate liquid command," and how much he invests in debt, which represents "deferred command over specific goods" convertible into money only at an uncertain future market price.

From this *ad hoc* and contrived description of the process by which an individual allocates his monetary assets, Keynes ([1936]

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1964, pp. 166–67) deduces that "the rate of interest cannot be a return to saving or waiting as such. For if a man hoards his savings in cash, he earns no interest, though he saves just as much as before. . . . Thus the rate of interest at any time, being the reward for parting with liquidity, is a measure of the unwillingness of those who possess money to part with their liquid control over it."

But why does such a thing as liquidity preference exist, especially when it is considered that the holding of money yields no explicit return? The first reason that Keynes ([1936] 1964, p. 168) gives involves the "transactions motive": the current transaction of business by consumers and producers requires a ready supply of cash and, in a world in which the individual's income receipts and disbursements are not synchronized, this entails that "up to a certain point it is worthwhile to sacrifice a certain amount of interest for the convenience of liquidity."

Two additional factors, unrelated to anticipated transactions, motivate a preference for liquidity: precaution and speculation. According to Keynes ([1936] 1964, p. 168), the necessary precondition of both the precautionary and speculative motives for holding cash "is the existence of uncertainty as to the future of the rate of interest. . . ." The precautionary motive explains the compensation for the sacrifice of interest by the insurance which the possession of liquid wealth provides against the capital loss that may be incurred when an unforeseen need for cash necessitates a hasty liquidation of debt securities. The speculative motive for cashholding emerges in an economy where, in addition to interest-rate uncertainty, there exists "an organized market for dealing in debts," e.g., a bond market (Keynes [1936] 1964, p. 169). Thus the individual "who believes that future rates of interest will be above the rates assumed by the market, has a reason for keeping actual liquid cash" (Keynes [1936] 1964, p. 170).

While liquidity preferences due to the transactions and precautionary motives are assumed by Keynes to depend on income and to be insensitive to fluctuations in the current rate of interest, the demand for liquidity for speculative purposes, where there exists a divergence of expectations among speculators regarding the future, is portrayed as varying inversely with the rate of interest. Thus, concludes Keynes ([1936] 1964, p. 171), "the rate of interest and the price of bonds have to be fixed at the level at which the desire on the part of certain individuals to hold cash (because at that level they feel bearish of the future of bonds) is exactly equal to the amount of cash available for the speculative-motive." Particularly where "the existence of an organized market gives an opportunity for wide fluctuations in

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liquidity preference due to the speculative motive" (Keynes [1936] 1964, pp. 170–71), changes in the interest rate in a capitalist economy reflect nothing more significant than the irrational migrations of speculators to and fro between the herds of bulls and bears.

From this analysis, Keynes ([1936] 1964, p. 203) is led to conclude that "the rate of interest is a highly conventional . . . phenomenon. For its actual value is largely governed by the prevailing view as to what its value is expected to be. *Any* level of interest which is accepted with sufficient conviction as *likely* to be durable *will* be durable. . . ." Moreover, where the opinion prevails that "the level of the rate of interest is self-adjusting, so that the level established by convention is thought to be rooted in objective grounds much stronger than convention," the interest rate may persist at a level that is too high for full employment. Keynes ([1936] 1964, p. 204) refers to "[t]he difficulties in the way of maintaining effective demand at a level high enough to provide full employment, which ensue from the association of a conventional and fairly stable long-term rate of interest with a fickle and highly unstable marginal efficiency of capital. . . ."

Even if an enlightened monetary authority were determined to drive the gross market rate of interest down in order to create a gap between the MEC and the interest rate sufficiently large to call forth a full-employment or "optimum" level of investment spending, its efforts in this direction would be limited by two factors. First, there is what has come to be termed the "liquidity trap," which raises the possibility that "after the interest rate has fallen to a certain level, liquidity preference may become absolute in the sense that almost everyone prefers cash to holding a debt which yields so low a rate of interest" (Keynes [1936] 1964, p. 207).

While a good case can be made that many commentators on the *General Theory* have routinely misinterpreted and overemphasized the theoretical and practical significance which Keynes attaches to the liquidity trap (Meltzer 1988, pp. 270–80), the same certainly cannot be said of the second factor that Keynes cites as impeding any attempt to reduce the interest rate, which has been virtually ignored. This second impediment consists, according to Keynes ([1936] 1964, p. 208) of "the intermediate costs of bringing the borrower and ultimate lender together, and the allowance for risk, especially for moral risk, which the lender requires over and above the pure rate of interest." Thus, even if the monetary authority were to succeed in reducing the pure rate of interest or the liquidity premium to zero, an insuperable barrier to optimum investment and full employment could still exist in the form of the "effective rate of interest" stuck at too high a level and composed of irreducible costs of financial intermediation plus a

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risk premium to compensate the lender for moral and other risks of the borrower's default. This factor "may prove important in an era of low interest rates" (Keynes [1936] 1964, p. 208), which, as we shall see, Keynes looks forward to as the precondition of the transition to capital superabundance.

The liquidity preference theory thus represents the perfect instrument allowing Keynes to translate his longstanding ethical prepossessions regarding usury and avarice into scientific policy dicta. Keynes's reference to the impending "euthanasia of the rentier" is not an isolated flight of fancy but the central implication of his program to rid the economy of the baneful effects of usury and avarice by suppressing the rate of interest and thereby abolishing the bond market.

As noted above, for Keynes, the bond market is born out of the irrational and otiose separation between those who finance and those who implement investment projects. This separation serves to create a unique and unnecessary risk, i.e., of the borrower's default, which increases the cost of investment. Furthermore, by providing an arena for speculation on interest-rate uncertainty, the organized bond market promotes avarice in the form of the speculative demand for cash holding. It is this demand which is the active factor in determining and driving the pure rate of interest; that is, the liquidity premium which must be paid to the avaricious for parting with monetary investment funds. Because the existence of the pure interest rate renders the ownership of debts competitive with the ownership of real capital assets, it further raises the cost and retards the rate of investment.

It is because the liquidity preference theory of interest establishes such a clear causal link between vice and economic instability and waste that Keynes steadfastly refused to relinquish it in favor of the scientifically more rigorous, general-equilibrium explanation, which emphasizes the simultaneous determination of the levels of income and the interest rate by saving and investment on the one hand and liquidity preference and the quantity of money on the other. As Patinkin (1976, p. 99) argues: "This tenet [that liquidity preference is the sole determinant of the interest rate] indeed served Keynes as a test of faith for all who wanted to be regarded as true converts to his new theory." In this spirit, Keynes was to "absolve" Harrod of misunderstanding this crucial aspect of his analysis (Patinkin 1976, p. 99).

Hansen (1953, p. 155) characterizes those chapters of the *General Theory* in which Keynes discusses the nature of capital as "another detour which could be omitted without sacrificing the main argument." And it is true that Keynes did not emphasize the "scarcity

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theory" of capital, which he develops in chapter 16, as a contribution on a par with effective demand, liquidity preference, and the marginal efficiency of capital. Keynes may have downplayed his contribution in this area because his treatment consisted of a series of loosely connected observations rather than a fully integrated theory. Nonetheless, the view of capital which emerges from these observations is crucial to the analytical progression of the main argument of the *General Theory*.

Keynes aims at establishing two fundamental propositions regarding capital. The first is that "an asset offers a prospect of yielding during its life services having an aggregate value greater than its initial supply price . . . because it is scarce; and it is kept scarce because of the competition of the rate of interest on money" (Keynes [1936] 1964, p. 213). The implication is that, given its physical productivity, the less scarce capital becomes the lower its yield in excess of its supply price.

In support of this proposition, Keynes ([1936] 1964, p. 213) alludes to the "pre-classical doctrine" that "everything is *produced* by *labor*," aided by technology, natural resources and capital or "past labor embodied in assets." Like natural resources, then, the price of the latter aid to labor is also determined by its "scarcity or abundance."

Keynes's second proposition holds that at any given moment in time, the opportunity for capital investment is strictly limited. According to Keynes ([1936] 1964, p. 214), while there are admittedly some roundabout processes of production that are physically efficient, probably most are very inefficient due to the phenomenon of "spoiling or wasting with time." This implies a conception of roundaboutness that is restricted to currently used techniques and production functions in which there is little scope for intertemporal substitution among inputs. Thus Keynes ([1936] 1964, p. 217) writes that "[i]n the case of the great majority of articles, it would involve great technical *in*efficiency to start up their input more than a very modest length of time ahead of their prospective consumption."

But the investment of labor in the production of capital assets is even more narrowly limited by the fact that, for any given quantity of labor, there is an optimum proportion between capital and labor, i.e., "between the amount of labor employed in making machines and the amount which will be employed in using them" (Keynes [1936] 1964, p. 214). The structure of production could be advantageously lengthened beyond this limit to exploit the remaining physically more efficient and even some inefficient lengthy processes of production, only if preferences to postpone consumption into the future were

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strong enough to necessitate a rate of investment so great as to provoke a negative MEC. In this case, short efficient processes must be rendered sufficiently scarce to compensate for the effect on their product price of the relative disagreeableness attending early consumption.

The optimum roundaboutness of the production structure is thus fixed and depends on the given supply of labor in conjunction with the given structure of dates at which consumer demand for the various products is expected to become effective, taking into account the circumstance that the lengthening or shortening of certain processes may so improve the quantity or quality of their products as to induce consumers to postpone or anticipate their prospective demands. Thus, in the case of a zero rate of interest, "there would be an optimal interval for any given article between the average date of input and the date of consumption, for which labor cost would be a minimum" (Keynes [1936] 1964, p. 216). A shorter or longer interval would be technically, as well as economically, less efficient. If the interest rate were above zero, the optimum interval would be contracted, necessitating a curtailment of current investment so as to achieve the greater scarcity of future products necessary to raise their prices enough to absorb the interest charge and the higher costs associated with the employment of technically less efficient shorter processes.

For Keynes, then, the interest rate constitutes the narrowest limit on investment. But even if a zero interest rate prevailed, Keynes's analysis implies that "there is a strict limit to the proportion of consumers' demand which it is profitable to begin providing for in advance" (Keynes [1936] 1964, p. 217).

In terms of practical policy, the conclusion Keynes ([1936] 1964, p. 375) draws from this analysis is momentous: "I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to a point where its marginal efficiency had fallen to a very low figure."

Keynes's analysis of capital completely ignores Böhm-Bawerk's seminal insight that capital accumulation permits the adoption of new techniques and production functions which, though previously known, remained unexploited precisely because the prevailing scarcity of capital rendered their implementation uneconomic. Thus, contrary to Keynes, progressive accumulation of capital requires and facilitates, within wide limits, an ever-increasing proportion of the given labor supply to producing capital goods. The growing quantity of labor inputs is applied not merely to "making machines," i.e., replicating existing machinery with existing techniques, but to making different and more efficient machines, to making existing machines

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more efficiently by building and using machines to make machines, to making the new machines necessary to mass produce luxury goods, e.g., the automobile, and to inventing new production processes and machines intended to supply heretofore latent wants.

It is illuminating to note the subtle connection between Keynes's analysis of the limits to capital accumulation and his Marshallian theory of wants and its key role in his millennialist social vision. It is precisely the assumption that the broad classes of wants are definitely limited, easily identified and enumerated, and capable of being supplied by existing production techniques, which enables Keynes to envisage that human wants will be surfeited and the millennium achieved with an extra generation or two of capital accumulation. However, once the possibility is raised, as it is by Böhm-Bawerkian capital theory, that capital accumulation itself is capable of stimulating the realization and expression of hitherto undreamed of wants, the rat race for progressively increasing living standards is on and the vision of capital saturation amid the blissful stagnation of the millennium recedes into the remote future or dissipates altogether (compare Johnson and Johnson 1978, pp. 80–81, and Minsky 1975, pp. 151–53).

As Minsky (1975, p. 154) perceptively comments, Keynes's world is one "in which 'civilized' standards discipline and control relative needs and move consumption away from capital-intensive patterns. A world in which an endless accumulation of gadgetry and weaponry is the desire of man is not a world in which full investment will soon occur." It is open to speculation whether Keynes's initial hatred of the automobile (Hession 1984, p. 57) and his reported discomfort with the telephone stemmed from his view that such capital-absorbing gadgets represented a departure from the "state of disciplined wants" (Minsky 1975, p. 155) that is necessary to achieve capital saturation.

Indeed, it is precisely because almost all "Keynesian" economists, especially in the United States, have ignored the fourth building block of the strict limitation on the demand for capital that they have been able to regard the analytical technique of the *General Theory* as providing the means for fine-tuning and stabilizing capitalism, instead of, as Keynes intended it, the justification and recipe for its destruction. Thus, no sooner is the fourth and final building block represented by the scarcity theory of capital rolled into place, than Keynes uses his completed theoretical apparatus to deliver the *coup de grace* to capitalism. This is the demonstration that laissez-faire capitalism, given prevailing institutions and psychological propensities, even if it miraculously found itself in the blessed state of capital satiety, would be unable to sustain this economic Eldorado.

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For his demonstration, Keynes ([1936] 1964, p. 217) supposes a society that possesses a capital stock of such a magnitude that any further investment would render the MEC negative. In graphical terms, we may envision an MEC schedule which intersects the origin and otherwise lies entirely within the second and fourth quadrants, with any level of positive investment inducing a negative MEC. It is also supposed by Keynes that, in this economy, money does not physically depreciate or involve significant costs of storage, therefore implying that the interest rate can never be negative, and the social propensity to save exceeds zero at the full-employment level of income. In these conditions, effective demand would consist only of expenditures on consumption and would be insufficient to take up the full flow of output forthcoming at a full-employment level of income. The result is that both the level of employment and the capital stock will have to shrink in order to reduce income to a level at which aggregate saving is zero.

Based on this analysis, Keynes ([1936] 1964, pp. 217–18) concludes that thus "for a society such as we have supposed, the position of equilibrium, under conditions of *laissez-faire*, will be one in which employment is low enough and the standard of life sufficiently miserable to bring savings to zero. . . . [T]he equilibrium stock of capital which will have a marginal efficiency of precisely zero, will, of course, be a smaller stock than would correspond to full employment of the available labor; for it will be the equipment which corresponds to that level of unemployment which ensures zero saving." The implication of course, is that pushing the rate of interest to "vanishing point" via government monetary policy may not be sufficient to induce the state of full investment prerequisite to entering the millennium. There is the possibility, however, that the desire of the public to make provision for the future would become satiated, causing the propensity to save out of full-employment income to fall to zero, at some point before the rate of interest reaches zero.

However, this unlikely possibility of spontaneous salvation under capitalism, according to Keynes ([1936] 1964, pp. 218–19), is rendered even less likely when it is considered that there are certain institutional and psychological factors, "in particular, the costs of bringing borrowers and lenders together and uncertainty as to the future of the rate of interest," operating to set a lower limit on the rate of interest significantly above zero.

Ensconced as it is in the generally neglected chapter on capital, most commentators on the *General Theory* have overlooked the most important application of its analytical apparatus. This is to the explanation of how an accumulation of capital, "so large that its

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marginal efficiency has fallen more rapidly than the rate of interest can fall in the face of the prevailing institutional and psychological factors, can interfere, in conditions mainly of laissez-faire, with a reasonable level of employment and with the standard of life which the technical conditions of production are capable of furnishing" (Keynes ([1936] 1964, p. 219). The ultimate moral and technical perversity of capitalism thus rests on the demonstration that it transmogrifies and diverts the process of wealth creation and progress toward moral perfection to a descent into a permanent state of relative impoverishment wherein vice can never be transcended.

For Keynes ([1936] 1964, p. 219), however, there is a way out, because "This disturbing conclusion [regarding the effects of capital accumulation] depends, of course, on the assumption that the propensity to consume and the rate of investment are not deliberately controlled in the social interest but are mainly left to the influences of *laissez-faire*." The political economy of the *General Theory* is thus primarily addressed not to securing the short-run stability of output and prices but to promoting the long-run, evolutionary goal of solving the economic problem.

Keynes lays out his politico-economic proposals in the final chapter of the *General Theory*, and they are clearly and specifically aimed at "depriving capital of its scarcity-value within one or two generations." The measures elaborated to achieve this aim involve "central controls," a term Keynes ([1936] 1964, pp. 377–79) uses four times within the space of three pages. These measures are designed to enable the State "to determine the aggregate amount of resources devoted to augmenting the instruments [of production] and the basic rate of reward to those who own them" and also "to bring about an adjustment between the propensity to consume and the inducement to invest" (Keynes [1936] 1964, pp. 378–79). In addition to full investment, these measures are designed to achieve the supplementary goals of full employment and equitable distribution of income.

Keynes's primary policy prescription is for a gradual and steady reduction in the rate of interest to zero. Because Keynes is referring to the market or effective rate of interest, which includes, in addition to the liquidity premium, the various costs and risk premiums associated with bringing borrowers and lenders together, he argues that monetary policy is incapable of effecting this outcome on its own. Thus he advocates "a somewhat comprehensive socialization of investment," which is the only way in which the institutional rigidity of the interest rate can be broken and, therefore, "the only means of securing an approximation to full employment" in the conditions of accumulating capital and a secularly declining MEC.

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While a longtime advocate of neo-Keynesian fine-tuning, such as Tobin (Brunner 1987, pp. 53–54), downplays the significance of Keynes's use of the term "socialization of investment" by adducing its varied connotations, Keynes is reasonably clear about the economic arrangements he intends to connote by the term. The central controls which Keynes ([1936] 1964, p. 378) advocates do not necessitate the assumption by the State of "the ownership of the instruments of production." Indeed, Keynes ([1936] 1964, p. 374) expatiates, albeit patronizingly, on the social usefulness of "money-making" and "private wealth-ownership" in the pre-millennial world in which men have not yet been "taught or inspired or bred" to take no interest in such activities.

What Keynes does envision in proposing the socialization of investment is the replacement of individual saving and allocation of investment funds via debt and equity purchases on private markets by "communal saving through the agency of the State" ([1936] 1964, p. 376).[2] In this way, the irrational and speculative stock and bond markets will give way to Marshallian owner-entrepreneurs, who, in consultation with Burkean State financiers and using the principles of Keynes's probability theory, will rationally forecast the marginal efficiencies of the various types of capital goods and defeat "the dark forces of time and ignorance" (compare Brunner 1987, p. 38).

The progressive expansion of the capital stock brought about by the policy of continually reducing the interest rate will drive the MEC

[2]There has been recurring and unresolved controversy surrounding the question of whether or not Keynes was an advocate of socialism. Of course, the resolution of this issue turns on the precise meaning to be attached to Keynes's call for "the socialization of investment." If it is interpreted, as I argue it should be, as a scheme to abolish equity and debt markets, then Keynes was indeed advocating the substitution of socialist central planning for a market economy. For as Mises points out, the existence of a stock exchange is precisely what distinguishes a functional market economy from a socialist economy. The retention of nominally private ownership of the means of production without the effective right of alienating such ownership titles in monetary exchanges deprives entrepreneurs of the ability to ascertain production costs, calculate ever-changing profit opportunities, and respond to these opportunities by rearranging existing combinations of capital goods. Centrally controlled investment, therefore, implies centrally planned production processes. Thus, for example, under National Socialism in Germany, although private ownership of business assets was formally retained, all important production activities were carried on under the directives of state officials.

Mises's remark on the existence of a stock exchange as the *sine qua non* of a market economy is reported in Rothbard 1991, p. 59. For the original statement of Mises's classic argument that the abolition of markets and prices for capital goods renders the rational allocation of resources impossible, see Mises [1920] 1990. For a detailed description of the pre-war Nazi economy which emphasizes its essentially socialistic character, see Reimann 1939.

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schedule steadily to the left until it reaches its evolutionary terminus at its intersection with the origin point. Actually, the MEC would not quite reach zero but would fall to "a very low figure" which would provide "some margin to cover risk and the exercise of skill and judgment" of the investing entrepreneur. Thus the gross yield on capital goods over their lives would "just cover their labor costs of production *plus* an allowance for risk and the costs of skill and supervision," there being no surplus left over for payment of a scarcity premium for the use of capital (Keynes [1936] 1964, pp. 375–76). In this state of full investment would therefore occur "the euthanasia of the rentier" and "the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital" (Keynes [1936] 1964, p. 376). Depriving the rentier or functionless investor of an income would also improve the equity of income distribution.

While the goal of an optimum rate of investment is to be insured by the policy of steady reduction of the interest rate, the goal of full employment depends upon the level of aggregate demand, composed of consumption and investment expenditures. Although a declining interest rate also tends to weaken the incentive to save and thus to stimulate consumption, Keynes still requires a second lever adapted specifically to changing the average propensity to consume. According to Keynes ([1936] 1964, pp. 378, 380), "[t]he State will have to exercise a guiding influence on the propensity to consume. . . ." by virtue of its involvement "in the task of adjusting to one another the propensity to consume and the inducement to invest" to generate a full-employment level of income.

For this purpose, Keynes proposes a "scheme of direct taxation" which aims at redistributing income from higher to lower income groups and thereby raising the average propensity to consume. Keynes discounts any adverse supply-side effects of this taxation policy by asserting that the prevailing price of entrepreneurial ability and risk-taking is far in excess of its supply price. According to Keynes ([1936] 1964, pp. 376–77) "the entrepreneur *et hoc genus omne* . . . are certainly so fond of their craft that their labor could be obtained much cheaper than at present. . . ." Thus Marshall's attempt to enlist economic chivalry in the service of his fondest dream of increasing standards of life for the workers by reducing the supply price of "business ability in command of capital" is replaced by Keynes's intuition that the dream is already half true and awaits for its completion only the arrival of the tax collector.

With the interest rate, the rentier, and the speculator on financial markets suppressed by socialized investment and the "economic rent" received by entrepreneurs taxed away and used to subsidize

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State-provided benefits for laborers, the monetary expenses of producing goods are effectively reduced to reflect only their "real" costs of production, basically the disutilities of labor and legitimate risk-taking. Thus, for Keynes, the same central controls that secure full investment and full employment also operate to squeeze out from the production process all income payments that are unrelated to labor costs and to establish an equitable distribution of income.

Although sparse in its details, Keynes's scheme for State direction of investment and remuneration for productive activity bears more than a passing resemblance to Hjalmar Schacht's Nazi command economy, which was "based on three main controls: of costs, investment, and international trade" (Woolston [1941] 1968, p. 236). Indeed, as Brunner (1987, p. 38) points out, in order to preclude the inevitable capital efflux induced by the pegging of domestic interest rates below world levels, Keynes recognized the necessity of a system of exchange controls that "would have to be rather far-reaching and also cover domestic transactions related in some manner to international transactions." In the early 1940s, Keynes also vigorously promoted the "Schachtian device" of international barter as an alternative policy for Britain in the post-war world, if some version of his scheme for international monetary reconstruction were not accepted. Keynes (quoted in Hession 1984, p. 331) labelled anyone who signed an agreement to preclude the use of such a device in advance "as great a traitor to his country as if he were to sign away the British navy before he had a firm assurance of an alternative means of protection."

There is some evidence that Keynes himself recognized the similarity between the nationalist system based on socialized investment which he espoused and the National Socialist system of political economy implemented by Schacht in Germany. Thus, in the Foreword to the German edition of the *General Theory* published in 1936, Keynes notes that the aggregative theory of production expounded in the book "can be much easier adapted to the conditions of a totalitarian state than the theory of production and distribution of a given production put forth under conditions of free competition and a large degree of laissez-faire." Keynes also expresses satisfaction if his theory "can contribute a single morsel to a full meal prepared by German economists" (Martin 1971, pp. 203–05).

In the foregoing, I do not intend to tar Keynes with the brush of National Socialism. Far from it, I merely wish to point out that, as a millennialist theorist, Keynes trusted to his own intuition and moral rectitude in choosing and applying policies which, in the hands of the less enlightened or less righteous, would result in a social holocaust.

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Keynes himself makes this point in a revealing letter written to Hayek, in which he comments on the latter's critique of planning, *The Road to Serfdom*. Writes Keynes (quoted in Meltzer 1988, p. 191):

> I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more. . . . Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issue. . . .
>
> I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly which would be the way to hell if they were executed by those who think and feel wrongly.

While a great deal more can and should be said regarding the evolution of Keynes's economics under the influence of his sociopolitical vision, I believe that my investigation is sufficient to indicate that the technical economics and the political economy of the *General Theory* have a definite millennialist orientation. The analytical apparatus was developed by Keynes to embody the ethical principles which he believed would govern his envisioned millennium. It was designed *ab ovo* to link up the economic failures of capitalism with the vices it characteristically fosters, "avarice, usury, and precaution."

Moreover, it was Keynes's eagerness to attain the economic precondition of this millennial state, the abolition of capital scarcity and the satiating of "disciplined" wants, which guided his application of this apparatus in formulating policy conclusions. Thus, to emphasize again, the policies which Keynes deduced were not policies of short-run fiscal fine-tuning that have come to be associated with his name. Keynes was single-minded in his politico-economic advocacy: What was required was a socialized investment policy designed to abolish financial markets and the interest rate and achieve capital saturation.

Even when he was specifically addressing the issue of short-run instability in his chapter on the "trade cycle," the tune he was playing never changed or even wavered in pitch. Under *laissez-faire* capitalism, the recurrence of "wide fluctuations in employment" could not be avoided "without a far-reaching change in the psychology of investment markets such as there is no reason to expect." He concluded that ". . . the duty of ordering the current volume of investment cannot safely be left in private hands" (Keynes [1936] 1964, p. 320). Again this is not to deny that Keynes ([1936] 1964, p. 325) supported measures for manipulation of the level of consumption, but it is clear that he viewed such measures as supplementary to his policy of socialized investment.

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How and How Not to Desocialize

Murray N. Rothbard*

Everyone in Eastern Europe and the Soviet Union is seemingly anxious to desocialize, to institute free markets and privatization. Plans profilerate, and innumerable Western economists are being consulted on how to go about this daunting task. It is generally acknowledged that bureaucrats are obstructing the process, but confusion abounds among free-market proponents themselves. Matters are scarcely helped by the fact that Western economists, to whom the former Eastern bloc is looking for wisdom, have themselves done virtually nothing to study, let alone solve, this problem during the sixty years since Stalin established socialism in the Soviet Union and the half-century since the Soviets imposed it on Eastern Europe. For ever since the mid-1930s, almost all Western economists have accepted the view that there is no calculation problem under socialism, and most have accepted the subsequent notion that the Soviet economy has been successful and growing, and would shortly overtake that of the United States.[1]

How Not to Desocialize

We may first clear the way on how to desocialize by examining various paths that have become popular, and yet are decidedly *not* the way to arrive at our presumably common goal.

How *not* to go about desocialization may be highlighted by the story of a friend of mine, who told me recently about a Soviet colleague

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[1]Murray N. Rothbard, "Ludwig von Mises and the Collapse of Socialism," delivered at the annual meeting of the Allied Social Science Association, at Washington, D.C., 1990, and published as "The End of Socialism and the Calculation Debate Revisited," *Review of Austrian Economics*, 5, no. 2 (1991): 51–76.

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in his department, who came to the United States to study diligently the problem of how to create a futures market in the U.S.S.R. He has been stymied by the fact that he cannot seem to figure out what laws or edicts the Soviet state should lay down, so as to replicate the futures market in the United States. In short, he cannot find a way to plan a futures market. Here then is a crucial point: *you cannot plan markets*. By their very nature, you can only set people free so that they can interact and exchange, and thereby develop markets themselves. Similarly, several of the socialist countries, seeing the importance of the capital markets in the West, have been trying to develop stock exchanges, but with little success. First, again, because stock markets cannot be planned, and, second, because, as we will see further, you cannot have markets in titles to capital if there are still virtually no private *owners* of capital in existence.

Do not Phase In

It is, again, generally accepted that free markets must be arrived at quickly, and that phasing them in slowly and gradually will only delay the goal indefinitely. It is well known that the giant socialist bureaucracy will only seize upon such delay to obstruct the goal altogether. But there are further important reasons for speed. One, because the free market is an interconnected web or lattice-work; it is made of innumerable parts which intricately mesh together through a network of producers and entrepreneurs exchanging property titles, motivated by a search for profits and avoidance of losses, and calculating by means of a free price system. Holding back, freeing only a few areas at a time, will only impose continuous distortions that will cripple the workings of the market and discredit it in the eyes of an already fearful and suspicious public. But there is also another vital point: the fact that you cannot plan markets applies also to planning for phasing them in. Much as they might delude themselves otherwise, governments and their economic advisers are not in a position of wise Olympians above the economic arena, carefully planning to install the market step by measured step, deciding what to do first, what second, etc. Economists and bureaucrats are no better at planning phase-ins than they are at dictating any other aspect of the market. To achieve genuine freedom, the role of government and its advisers must be confined to setting their subjects free, as fast and as completely as it takes to unlock their shackles. After that, the proper role of government and its advisers is to get and keep out of the subjects' way.

Do Not Crack Down on Black Markets

One route toward freedom that former President Gorbachev had adopted was to crack down on the villains of the black market. We

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might conclude that the mindset of the Eastern bloc has a long way to go in understanding freedom, except that there are precious few Westerners who understand this problem either. For the black marketeers are not villains; if they sometimes look and act like villains, it is only because their entrepreneurial activities have been made illegal. The "black market" is simply *the market*, the market which Soviets claim to be searching for, but which has turned "black" precisely because it has been declared illegal. It is the market crippled and distorted, but it is there, in this despised "black" area, that the Soviets will find the market most readily. Instead of cracking down, then, the governments should, immediately, set the black market free.

Do Not Confiscate the People's Money

The Soviet Union suffers from the problem of "ruble overhang," that is too many rubles chasing too few goods. It is generally admitted that the "overhang" is the result of comprehensive price fixing, by which the government has set prices far below market-clearing levels. Over the years, the Soviet government has been rapidly printing new money to finance its expenditures, and this increased money supply, coupled with ever-dwindling supply of goods resulting from the breakdown of socialist planning, has created aggravated shortages and an excess supply of money over goods available.

It is commonly acknowledged that the shortages will be relieved and the overhang abolished, if prices were set free to move. But the government fears the wrath of unhappy consumers. Perhaps, but it is scarcely a solution to do what Gorbachev did, that is, follow the uninspired path of the Brazilian "free market" President Collor de Mello, who in the spring of 1990, in an attempt to reverse hyperinflation, arbitrarily froze 80 percent of all bank accounts. Gorbachev did one better by suddenly making useless all large-ruble bills, allowing only a small number to be exchanged for smaller dominations. This is no way to eliminate an overhang; at best, the cure is much worse than the disease. In the first place, in this supposed strike at black marketers, it has been rather the savings of the average Soviet that has been destroyed, since the black marketeers were shrewd enough to have moved already into precious metals and foreign currency. But even more important: By this action, the government delivers the second body blow of a one-two punch at the average citizen, and at the economy. The first punch was for the government to inflate the money supply so as to engage in its usual, wasteful expenditures. Then, after the money has been spent, and prices driven up—in either open or repressed fashion—then the government, in its wisdom, begins

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to exclaim at the horrors of inflation, blames black marketeers, greedy consumers, the rich, or whatever, and proceeds to the second monstrous punch of confiscating the money long after it has come into private ownership. Whether or not one calls this process "free market," it remains confiscatory, unjust, statist, and a double set of implicit taxes and burdens upon the economy.

Do Not Increase Taxes

Unfortunately, one of the "lessons" that many East Europeans have absorbed from Western economists is the alleged necessity of sharply raising taxes and making them progressive. Taxes are parasitic and statist; they cripple energies, savings, and production. Taxes invade and aggress against the rights of private property. The higher the taxes, the more the economy becomes socialistic; the lower they are, the closer the economy approaches true freedom and genuine privatization, which means a system of complete rights of private property. The Mazowiecki attempt to achieve privatization and free markets in Poland was greatly hampered by the imposition of far higher and progressive taxes.

As part of the shift toward freedom and desocialization, then, taxes should be drastically lowered, not raised.

Government Firms Owning Each Other is Not Privatization

I owe to Dr. Yuri Maltsev the information that the much-vaunted Shatalin plan for the Soviet Union, which was supposed to bring about privatization and free markets in 500 days, was really not privatization at all. Apparently, existing government firms in each industry, instead of being actually privatized—that is, owned by private individuals—would have been owned (or 80 percent owned) by other firms in the same industry. This would mean that giant state monopoly firms would continue to be state monopoly firms, and be self-perpetuating oligarchies rather than truly privately owned. Privatization must mean private property.[2]

[2]As Maltsev writes: "When the Soviets say privatization, however, they don't mean what we do by the term. The [Shatalin] plan would mandate that 80 percent of the stock of any enterprise be owned by other enterprises in the same field, not the public. To use a U.S. analogy, it would be as if General Motors owned 80 percent of Ford's stock and vice versa, and it were illegal to have it otherwise." Maltsev notes that Stanislav Shatalin, and the original author of his plan for the Russian Republic, Grigory Yavlinsky, "are both econometricians whose . . . lives have been spent in mathematizing the delusions of Marxism-Leninism. They are both long-time central planners who became disillusioned with full-blown socialism." Yuri N. Maltsev, "A 500-Day Failure?" *The Free Market* 8 (November 1990): 6.

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How to Desocialize

The following points of desocialization must necessarily be written or read sequentially, but they need not be carried out in that manner: all the following points could, and should, be instituted immediately and all at once.

Legalize the Black Market

The first two planks are implicit in the previous part of this paper. One, is to legalize the black market, that is to make all markets free and legal. That means that the private property of all those engaging in such markets must, along with everyone else, be made secure from government depredation, secure as a right of ownership. It means also that all goods and services hitherto illegal are now to be legal, whether they are legal in the West or not, and that all transactions are to be engaged in freely, that is, that prices are to be set voluntarily by the exchanging parties. Thus, all government price control is to be abolished forthwith. If such genuine prices for real transactions are to be higher than pseudo-"prices" set by the government for non-existent transactions, then so be it. Consumer griping should simply be ignored; any consumers who still prefer the previous regime of fixed prices for non-existent goods will, of course, be free to boycott the new prices and try to find cheaper sources of supply elsewhere. My hunch, however, is that consumers will adjust soon enough to these one-shot changes, especially since unprecedented abundance of consumer goods will quickly pour forth onto the markets.

By "legalizing," by the way, I mean simply abolishing a previous outlaw status; I do not propose to engage in semantic exercises trying to distinguish between "legalizing" and "decriminalizing."

Drastically Lower All Taxes

Another implication of our previous analysis is that taxation should be cut drastically. There is, in the literature on taxation, far too much discussion about which types of taxes are to be imposed, and who is to pay them and why, and not nearly enough on the height or amount of taxes to be levied. If the tax rate is low enough, then the form or principles of tax distribution really makes very little difference. To put it starkly, if all tax rates are kept below one percent, then it really does not matter much economically whether the taxes are on incomes, sales, excises, property, or capital gains. It is important instead to focus on how much of the social product is to be siphoned off to the unproductive maw of government, and to keep that burden ultra-minimal.

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While the form of taxation would not then matter economically, it would still matter *politically*. An income tax, for example, however low, would still maintain an oppressive system of secret police ready and willing to investigate everyone's income and spending and hence his entire life. Economists' opinion to the contrary, there is no tax or system of taxes that could be neutral to the market.[3] Whatever taxation that might exist after desocialization should, however, be as close to neutral as possible. This would mean, in addition to very low rates and amounts, that the taxation be as unobtrusive and harmless as possible, and imitate the market as closely as it can. Such imitation might include the voluntary sale of goods and services at a price, or setting a price for participating in voting. The sale of goods or services by the government would, of course, be drastically limited in our desocialized system, because of the enormous scope of privatization of government activities. Privatization will be treated below.

Abolish the Government's Ability to Create Money

There are three parts to any government's ability to generate revenue: taxation, the creation of new money, and the sale of goods or services.[4] There can be no genuine free market or desocialization so long as government is permitted to *counterfeit* money, that is create new money, whether it be paper tickets or bank deposits, out of thin air. Such money creation functions as a hidden and insidious form of taxation and expropriation of the property and resources of producers. Ending counterfeiting means getting the government out of the money business, which in turn implies eliminating both government paper money and central banking. It also means denationalizing currency units, such as the ruble, forint, zloty, etc., and returning them to private market hands. Denationalizing currency can only be achieved by redefining paper currencies in terms of units of weight of a market metal, preferably gold. When the central banks are liquidated, they could disgorge their gold hoards; as their last act on earth they could redeem all their paper tickets at the redefined weight in gold coins.

While, given the will to desocialize, this monetary denationalizing process is not as complex or difficult as it may first seem, it might indeed take longer than the one day required for the other

[3]See Murray N. Rothbard, "The Myth of Neutral Taxation," *Cato Journal* 1 (Fall 1981): 519–64.

[4]A fourth form of revenue, borrowing from the public, is strictly dependent on the other three sources.

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parts of our plan.[5] There could then be transitional steps of a few days' length: that is, the ruble or forint could be allowed to fluctuate freely and be convertible at market exchange rates into other currencies. It would still be imperative to take the money-creating power out of the hands of the national government; a possible way of doing that, and a second transitional step, would be to make the ruble convertible into harder currencies, such as the dollar, at some fixed rate. Pending return to a pure gold standard and liquidation of the central bank, it would also be important to curb the government's power to create money by freezing permanently all central bank activities including open market operations, loans, and note issues. It need hardly be added that a law or edict limiting or freezing the government itself is *not* an act of intervention into the economy or society. Quite the contrary.

Just as black markets and all private markets would be set free, so too private credit institutions, for the lending of savings or the channeling of the savings of others, would be set free to develop.

Fire the Bureaucracy

A question may have occurred to the reader: If taxation is to be drastically lowered, and the government is to be deprived of its power to print or create money, then how is the government going to finance its expenditures and operations? The answer is: It wouldn't have to, because there would be precious little left for government to do. (This will be explained further in the discussion of privatization below.) The socialist economy is a command economy, staffed and run by a gigantic bureaucracy. That bureaucracy would immediately be fired, its members set free at long last to find productive jobs, and develop whatever productive abilities they might have, in the now rapidly expanding and flourishing private sector.

This brings us to a fascinating problem which, while resting long in the hearts and minds of the oppressed subjects of socialism, has now unexpectedly become a live political issue. What is to be done with and to the top Communist party cadre, to the *nomenklatura*, to the vast apparatus of the once all-powerful secret police? Should justice at last be meted out to them by a series of state-crime trials, followed by proper and condign punishment? Or should bygones be bygones, a general amnesty be declared, and ex-KGB men hired as private guards or detectives? I confess an ambivalence on this issue,

[5]See Yuri N. Maltsev, "A One Day Plan for the Soviet Union," *Antithesis* 2 (January/February 1991): 4, and in the earlier account, "The Maltsev One-Day Plan," *The Free Market* (November 1990): 7.

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in weighing the competing claims of justice and of social peace. Fortunately, the decision can be left to the peoples of the former Soviet Union and of Eastern Europe. There is not much that an economist, even a free-market economist, can say to resolve this issue.

Privatize or Abolish Government Operations

This brings us to the final, but scarcely the least important, plank of our proposed desocialization platform: privatizing government operations. Since theoretically all, or in practice *most*, production in socialist countries has been in the hands of the State, the most important desideratum, the crucial route for attaining a system of private property and free market, must be to privatize government operations.

But simply to say "privatize" is not enough. In the first place, there are many government operations, especially in socialist states, that we don't *want* to privatize, but rather to abolish completely. For example, we would not, as libertarians and desocializers, wish to privatize concentration camps, or the Gulag, or the KGB. God forbid that we should ever have an *efficient* supply of concentration-camp or secret police "services"!

Here is a point that needs to be underlined. The basic assumption of national income and GNP analysis is that all government operations are productive, that they contribute their expenses to the national output and the common weal. But if we truly believe in freedom and private property, we must conclude that many of these operations are not social "services" at all but *dis*services to the economy and society, "bads" rather than "goods."

This means that desocialization must involve the abolition, not the privatization, of such operations as (in addition to concentration camps and secret police facilities) all regulatory commissions, central banks, income tax bureaus, and, of course, all the bureaus administering those functions that are going to be privatized.[6]

Principles of Privatization

Genuine goods and services, then, are to be privatized. How is this to be accomplished? In the first place, private competition with

[6]It is important to realize that if a government activity is a bad rather than a good, we would want its exercise, so long as it exists, to be as *in*efficient rather than as efficient as possible. One of the most hated organizations in early modern Europe was the "tax farmer," who purchased from the king, the right to collect taxes for a certain term of years. We might consider: would we want income taxes to be privatized, and collected, fully armed with state power, by IBM or McDonald's rather then the IRS? The industrialist Charles F. Kettering is supposed to have cheered up a friend in the hospital, who was complaining about the accelerated growth of government: "Cheer up, Jim, thank God we don't get as much government as we pay for."

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previous government monopolies is to be free and unhampered. This would legalize not only the black market, but all competition with existing government operations. But what about the massive accumulation of government firms and capital assets themselves? How are they to be privatized?

Several possible routes have been suggested, but they can be grouped into three basic types. One is egalitarian handouts. Every Soviet or Polish citizen receives in the mail one day an aliquot share of ownership of various previously state-owned properties. Thus, if the XYZ steel works is to be privately owned, then, if there are 300 million shares of XYZ steel company issues, and 300 million inhabitants, each citizen receives one share, which immediately becomes transferable or exchangeable at will. That this system would be impossibly unwieldy is evident. The number of people would be too much and shares too few to allow every person to have a share, and there would be shares of innumerably large numbers and varieties that would quickly descend upon the heads of the average citizen. Much of this chaos would be eliminated in the suggestion of Czech finance minister Vaclav Klaus, who proposes that each citizen receive basic certificates, which could be exchanged for a certain number or variety of shares of ownership of various companies on the market.

But even under the Klaus plan, there are grave philosophical problems with this solution. It would enshrine the principle of government handouts, and egalitarian handouts at that, to undeserving citizens. Thus would an unfortunate principle form the very base of a brand new system of libertarian property rights.

It would be far better to enshrine the venerable *homesteading* principle at the base of the new desocialized property system. Or, to revive the old Marxist slogan: "all land to the peasants, all factories to the workers!" This would establish the basic Lockean principle that ownership of owned property is to be acquired by "mixing one's labor with the soil" or with other unowned resources. Desocialization is a process of depriving the government of its existing "ownership" or control, and devolving it upon private individuals. In a sense, abolishing government ownership of assets puts them immediately and implicitly into an *unowned* status, out of which previous homesteading can quickly convert them into private ownership. The homestead principle asserts that these assets are to devolve, not upon the general abstract public as in the handout principle, but upon those who have actually worked upon these resources: that is, their respective workers, peasants, and managers. Of course, these rights are to be genuinely *private*; that is, land to individual peasants, while

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capital goods or factories go to workers in the form of private, negotiable shares. Ownership is not to be granted to collectives or cooperatives or workers or peasants holistically, which would only bring back the ills of socialism in a decentralized and chaotic syndicalist form.

It should go without saying that these ownership shares, to be truly private property, must be transferable and exchangeable at will by their holders. Many current plans in the socialist countries envision "shares" which must be held by the worker or peasant and, for a term of years, could only be sold back to the government. This clearly violates the very point of desocialization. Other suggested plans impose severe restrictions upon the transfer of ownership to foreigners. Once again, genuine privatization requires complete private property, including sale to foreigners. There is, furthermore, nothing wrong with "selling the country" to foreigners. In fact, the more that foreigners purchase "the country" the better, for it would mean rapid injections of foreign capital, and therefore more rapid prosperity and economic growth in the impoverished socialist bloc.

A problem immediately arises in granting shares to workers in the factories, a problem akin to the question what is to be done with the Communist cadres and the KGB: Should the managing *nomenklatura* be cut in on the shares of ownership? In advising the Soviets in an address in Moscow in early 1990, the economist Paul Craig Roberts observed that the Soviet people could either cut the throats of the *nomenklatura* or cut them in on shares of ownership; for the sake of social peace and smooth transition to a free economy, he recommended the latter. As I wrote above, I would not be that quick to thwart the demands of justice; but I would like to point out again a third possible route: not doing either one, and freeing the *nomenklatura* to find productive jobs in the private sector. The philosophic point in contention is to what extent, if at all, the managers' activities in the old Soviet economy were productive, and therefore participant in homesteading-labor, and to what extent they were crippling and counter-productive, and therefore deserving of nothing better than a curt dismissal.[7]

A third commonly suggested route to privatization deserves to be rejected out of hand: that the government sell all its assets to the public at auction, to the highest bidder. One grave flaw in this approach is that since the government owns virtually all the assets,

[7]Yuri Maltsev recommends adoption of the homesteading plan, with the Vaclav Klaus distribution scheme to be adopted in cases where homesteading would not be feasible. Maltsev, "A One-Day Plan for the Soviet Union."

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where would the public get the money to purchase them, except at a very low price that would be tantamount to free distribution? But another, even more important flaw hasn't been sufficiently stressed: why does the government deserve to own the revenue from the sale of these assets? After all, one of the main reasons for desocialization is that the government does not deserve to own the productive assets of the country. But if it does not deserve to own the assets, why in the world does it deserve to own their monetary value? And we do not even consider the question: What is the government supposed to do with the funds after they have been received?[8]

A fourth principle of privatization should not be neglected; indeed, it should take priority. Unfortunately, by the nature of the case this fourth route cannot be made into a general principle. That would be for the government to return all stolen, confiscated property to its original owners, or to their heirs. While this can be done for many parcels of land, which are fixed in land area, or for particular jewels, in most cases, especially capital goods, there are no identifiable original owners to whom to restore property.[9] In the nature of the case, finding original landowners is easier in Eastern Europe than in the Soviet Union, since far less time has elapsed since the original theft. In the case of capital goods built by the State, there are no owners to identify. The reason why this principle should take priority wherever it applies is because property rights imply above all restoring stolen property to original owners. Or to put it another way: An asset becomes philosophically unowned, and therefore available to be homesteaded, only where an original owner, if one had existed, cannot be found.

There is one nagging remaining problem: How large should the newly private firms be? Every industry in socialistic countries is generally locked into a monopoly firm, so that if each firm is privatized into an equivalent-sized firm, the size of each will be far larger than the optimum on the free market. A fundamental problem, of course, is that there is no way for anyone in a socialized economy to figure out what the optimum size or number of firms is going to be under freedom. In a sense, of course, mistakes made in the shift to

[8]One leading argument for the government selling its assets is that this process would have the anti-inflationary effect of sopping up the dread "ruble overhang." The fallacy in this egregious argument is that, unless the government officials propose to have a mass public bonfire of the rubles, the overhang would not be reduced at all. The government would spend the rubles, and they would remain in circulation.

[9]In Hungary, the Smallholders Party was formed to stress priority in privatization to returning land to the expropriated landholders of Southern Hungary.

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freedom will tend to iron themselves out after a free market is established, with tendencies to break up or to consolidate in the direction of optimum size and number. On the other hand, we must not make the mistake of blithely assuming that the costs or inefficiencies of this process may be disregarded. It would be preferable to come as close as possible to the optimum in the initial privatization. Perhaps each plant, or each group of plants in an area, may be initially privatized as a separate firm. It goes without saying that a very important aspect of a free market and of this optimizing process is to allow the market complete freedom to work: e.g., to merge, combine, or dissolve firms as it proves profitable.

Conclusion

The dimensions of the proffered Rothbard Plan for desocialization should now be clear: (1) Enormous and drastic reductions in taxes, government employment, and government spending. (2) Complete privatization of government assets: where possible to return them to the original expropriated owners or their heirs; failing that, granting shares to productive workers and peasants who had worked on these assets. (3) Honoring complete and secure property rights for all owners of private property. Since full property rights imply the complete freedom to make exchanges and transfer property, there must be no government interference in such exchanges. (4) Depriving the government of the power to create new money, best done by a fundamental reform that at one and the same time liquidates the central bank and uses its gold to redeem its notes and deposits at a newly defined unit of gold weight of existing currencies. All this could and should be done in one day, although the monetary reform could be done in steps taking a few days.

One point we have not specified: precisely how low should taxes or government employment or spending be set, and how complete should be the privatization? The best answer is that of the great Jean-Baptiste Say, who should be known for many other things than Say's Law: "The best scheme of [public] finance is, to spend as little as possible; and the best tax is always the lightest."[10] In short, that government is best that spends and taxes and employs the least, and privatizes the most.

A final point: I have been criticized by libertarian colleagues for proposals of this sort because they involve action by government. Isn't

[10]Jean-Baptiste Say, *A Treatise on Political Economy*, 6th ed. (Philadelphia: Claxton, Remsen & Haffelfinger, 1880), p. 449. Also see Rothbard, "The Myth of Neutral Taxation," pp. 551–54.

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it inconsistent and statist for a libertarian to advocate any government action whatever? This seems to me a silly argument. If a thief has stolen someone's property, it is scarcely upholding "robber-action" to advocate that the robber disgorge his stolen property and return it to its owners. In a socialist state, the government has arrogated to itself virtually all property and power of the country. Desocialization, and a move to a free society, necessarily involves the action of that government's surrendering its property to its private subjects, and freeing those individuals from the government's network of controls. In a deep sense, getting rid of the socialist state requires that state to perform one final, swift, glorious act of self-immolation, after which it vanishes from the scene. This is an act which can be applauded by any lover of freedom, act of government though it may be.

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The Role of Entrepreneurship in Desocialization

Jeffrey M. Herbener*

Now that communism has been repudiated across Central and Eastern Europe, the most pressing challenge for economic theory is to outline a process of desocialization for the former communist countries. Socialism's most obvious economic failure is its inability to produce the goods necessary for its citizens to have even a modest standard of living by Western, capitalist standards. Because, as Ludwig von Mises stressed, the entrepreneur is the driving force behind the social creation of wealth, any policy of desocialization must incorporate an understanding of the role of entrepreneurship in social production.[1] Because entrepreneurship is an integral part of their theories, Austrian school economists have more readily provided viable desocialization plans than those of other schools of thought.[2] Formulating a social system with the proper channels for entrepreneurial expression is essential for newly emerging capitalist countries and for interventionist ones, such as the United States, as they seek to revitalize their stagnating economies.

To anyone concerned with the problems of economic prosperity and the progress of civilization, an understanding of entrepreneurship and its institutional prerequisites is essential. The first step is to develop the economic theory of entrepreneurship applicable to every action; The next is to discuss entrepreneurship in a free market

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[1]Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, [1949] 1966), pp. 297, 299, and 336.

[2]It is a widely accepted observation that neoclassical economics has no significant role for the entrepreneur due to its formalistic character. At best the entrepreneur is an afterthought in neoclassical theory, awkwardly appended to its formal, usually mathematical, models. For example, see Israel Kirzner, *Discovery and the Capitalist Process* (Chicago: University of Chicago Press, 1985), pp. 1–25 and 68–92.

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and how it compares to entrepreneurship under a socialist system. Only then can one construct a program of desocialization that calls forth the greatest quantity and quality of entrepreneurial activity in social production and exchange.

The Role of Entrepreneurship in Human Action

Economic theory is constructed by deducing the necessary consequences of the irrefutable fact that human action exists.[3] The purposefulness of human action provides the foundational concepts from which all economic theory stems: ends, means, ideas, scarcity, choice, preference, value, cost, profit and loss, etc. When engaging in action an individual must evaluate potential courses of action, choosing one he prefers and setting aside others of lesser value; formulate ideas concerning how the end might be attained by the combining of means, choosing the highest evaluated recipe for action; and evaluate the means required by the recipe, come to control these means in action (i.e., own them) and so be able to combine them in an attempt to attain the end. In each action, the actor views means as either consumer goods, ones immediately available to satisfy an end, or producer goods, ones intermediate to the creation of a consumer good. Producer goods can be further sub-categorized into labor—human effort, land—naturally existing items, and capital—man-made goods. An essential feature of the means of production is diversity; not only is each person's labor different from that of every other person, so each parcel of land and each type of capital good is different from every other.

It follows immediately from the fact of action that when engaging in human action, i.e., applying means according to ideas to attain ends, individuals face an uncertain future. It is this uncertainty that calls forth the skill of entrepreneurship in each action a person takes. If the future state of affairs were known in advance with deterministic certainty, human action would be negated since the individual would not find it necessary to evaluate various ends (choosing the most preferred and setting aside others), to formulate ideas about how the end can be attained, nor to assess and accumulate the means he believes can be used cooperatively to attain the end. People would simply live out the preordained activities seen beforehand, never

[3]On the method of economics see Mises, *Human Action*, pp. 1–10 and 30–71; Hans-Hermann Hoppe, *Praxeology and Economic Science* (Auburn, Ala.: Ludwig von Mises Institute, 1988); and Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash Publishing, 1962), pp. 1–2 and 63–66. On these basic economic principles, see Rothbard, *Man, Economy, and State*, pp. 1–62.

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making errors in action caused by lack of foresight. Choice, as action requires it, would no longer be necessary; rather the problem of choice would be solved mechanically, much like solving an algebra problem.[4]

While not deterministic, neither can a person's perception of future states of affairs be random. The very existence of human action negates this possibility as well, since no action could be purposeful in a random world lacking any ability to predict the outcome of using means in any particular way, e.g., drinking milk nourishes one time and poisons the next. For human action to exist, the world outside the actor's mind must be orderly; i.e., characterized by time-invariant physical laws governing relationships among means, and subject to discovery by acting individuals.[5]

Uncertainty as a condition of human action lies between determinism and randomness, and implies the human capacity to form expectations of the future that do not diverge completely from it nor adhere completely to it.[6] Entrepreneurship is the human ability to deal with uncertainty. Since every action is taken in the face of uncertainty, every action exhibits entrepreneurship, either to a lesser or greater degree.[7]

For an isolated individual the problem of uncertainty, for which entrepreneurship must provide a solution, concerns only the physical laws governing the relationships among means and the perceptions of his mind. Any action Robinson Crusoe takes requires him to apply his

[4]This is precisely the neoclassical view of choice. While necessary to draw out the conclusions from the aspects of choice not concerned with uncertainty, economic theory is incomplete at best and absurd at worst until propositions incorporating uncertainty are developed. This is one area where Austrian economics is far in advance of neoclassical economics. The neoclassical economists' frequent assumption of no uncertainty leads them to accept mathematical techniques in building theory and forces them to ignore the crucial role of entrepreneurship in human action. On the use of the technique of imaginary construction to build economic theory see Mises, *Human Action*, pp. 236–37; on uncertainty in action, pp. 105–18; and on general equilibrium and entrepreneurship, pp. 244–56.

[5]See Mises, *Human Action*, pp. 22–27 and 99–100; and Hoppe, *Praxeology and Economic Science*, pp. 18–19 and 32–34.

[6]The absence of randomness in human action precludes the use of statistical techniques based on the assumption of a data-generating process that produces data randomly. Econometrics violates both conditions: the absence of determinism, by assuming constants, and the absence of randomness, by assuming probability distributions. See Frank Knight, *Risk, Uncertainty and Profit* (New York: Kelley and Millman, 1957) pp. 22–48 and 197–232; and Mises, *Human Action*, pp. 106–15.

[7]On the differences between entrepreneurship in every action and specialized entrepreneurs see Mises, *Human Action*, pp. 252–55.

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labor, which he owns naturally, to transform his physical surroundings into capital goods and eventually consumer goods (i.e., to homestead the island) which he then owns as the product of his labor. In so attempting to attain an end, he can act erroneously by, say, trying to catch fish with his bare hands because, e.g., he underestimates the difficulty of the task or he overestimates the benefit of having the fish.

The Role of Entrepreneurship in a Free Market

Those who wish to participate in the social interaction of voluntary exchange and the division of labor have additional and more difficult entrepreneurial tasks, namely, to discover and to forecast the subjective values of other people. Despite this obstacle, most people prefer engaging in social interaction, instead of acting in isolation, because they benefit from it. This benefit derives from a primal fact of human existence: Individuals differ from one another, both in subjective values and labor skills.[8] The former creates gain in subjective value from engaging in voluntary exchange as existing goods move from those who value them less to those who value them more, while the latter creates a gain in production from a division of labor as existing factors of production move from higher cost activities to lower cost activities. It is in these interactions that entrepreneurship finds its socially beneficial channels and plays its central role in the creation of society and progress of civilization.

The desire a person has to acquire the benefit of social interactions is insufficient to accomplish action in this setting. In addition, he must accurately forecast the subjective values of others to effectively participate in social production and exchange. Voluntary exchange requires that each person who wants to participate must produce and bring to market a good that other people find of sufficient subjective value that they will exchange valuable goods they own for it. While everyone must exhibit this skill to some extent, it is possible for individuals to arrange their production of consumer goods according to a division of labor where specialized entrepreneurs take over this function.

For most activities, people prefer the greater efficiency of arranging production according to comparative advantage and then obtaining goods by voluntary exchange, compared to self-sufficient productive

[8]Economic theories that ignore the diversity of labor, as well as that of other means, cannot adequately describe social production or explain the social role of entrepreneurship. See Mises, *Human Action*, pp. 157–65.

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efforts. Taking the factors of production he justifiably owns (his labor and homesteaded land and capital), each individual voluntarily contracts with others to use his property for specific tasks in cooperation with them. Entrepreneurship becomes a part of the division of labor as some show greater abilities to deal with uncertainties inherent in the process of social production. Specialized entrepreneurs perform the social functions of dealing with uncertainty, coordinating the diverse labor (and other factors) of numerous individuals, and directing production into the most socially valuable ends. The latter two activities would be impossible without money as a basis for economic calculation.

Money is essential for the development of any advanced, i.e., industrial, economic production.[9] Without it no cardinal unit common to all exchange would exist and thus, participants would have no basis for making meaningful comparisons of the social value and cost of using diverse goods in action. Prices, which can exist only in money terms, that are determined in voluntary exchange indicate the degree of scarcity of goods; i.e., the subjective value placed on them relative to the amount of them in existence. Because money prices reflect subjective value and exist in cardinal units, they can be the ingredients of economic calculation.

Calculation of profit and loss is the process by which individuals determine what and how to produce in the complex latticework of social production.[10] Without economic calculation, a social system would not be able to register true preferences for consumer goods or produce them rationally, i.e., taking account of opportunity costs. Money prices determined by the free exchange of private property ownership reflect the social scarcity of goods as individuals, demonstrating their preferences, freely buy, surrendering the value of other consumer goods, or refuse to buy, preferring the value of other consumer goods. Existing prices provide indispensable information from which entrepreneurial forecasts of the future scarcity of consumer goods can be made. Only then can entrepreneurs coordinate current productive activities to create those consumer goods with the greatest future social value.

The more difficult problem solved by economic calculation is selecting from the numerous techniques available to create a given consumer good. Without money prices, different techniques using various amounts and types of factors of production cannot be compared

[9]See Ibid., pp. 257–69, 405–08, and 520–23.
[10]See Ibid., pp. 200–31 and 698–715.

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since they are denominated in non-comparable units, e.g., labor in hours and land in acres. Each factor must be evaluated with a common standard, denominated in cardinal numbers, to make comparisons among the techniques possible. Money prices for the factors of production reflect the value of those factors in the production of alternative consumer goods; thus, by comparing the total monetary payments required to produce a given consumer good using different techniques, the entrepreneur can determine which technique is socially efficient; i.e., which results in the lowest value of foregone consumer goods. In the absence of economic calculation, choosing one technique from among the many available can only be done arbitrarily and hence, irrationally.[11]

Entrepreneurs guide social production toward the attainment of desirable consumer goods by assuming the function of coordinating those who cooperate in the division of labor. This is accomplished through voluntary exchange, as each entrepreneur forms a business firm to contract with owners of factors of production internally and then to contract with the firms of other entrepreneurs externally. [12] Through these contractual agreements, entrepreneurs construct a grand latticework of production from higher stage capital goods to lower stage capital goods to consumer goods. A structure of almost infinite complexity in its detail, requiring the coordination of all factors of production in the economic system, it is completely flexible in the service of changing consumer desires within the boundaries of private property ownership, technological possibilities, and existing capital goods. Entrepreneurs also bring about the transfer of factors of production across time, according to individual preferences, from producing current consumer goods to producing current capital goods necessary to build the structure so that the production of future consumer goods can increase.

It is through these contracts that entrepreneurs assume the uncertainty inherent in social production. They agree to pay the owners of the factors of production fixed sums of money in exchange

[11]This is why Mises describes central planners in socialism as "groping in the dark." See *Human Action*, pp. 700–01. He also points out that Robinson Crusoe cannot engage in economic calculation (*Human Action*, p. 205). However, calculation is unnecessary for solving the problem of acting for Crusoe; economic calculation is necessary only for social systems requiring coordination of a division of labor and hierarchy of capital goods.

[12]On contracting see Armen Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," *American Economic Review* 62 (December 1972): 777–95.

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for the use of these factors in production, the output of which they own, be it a capital good or consumer good. Because the market value of the factors is known in advance of production while the market value of the goods produced is not known until after they are produced, entrepreneurs become residual claimants, earning the profit or suffering the loss from the production process the magnitudes of which cannot be known in advance of production itself. It is their residual claimant status that links the incentive of entrepreneurs to actions that have demonstrable social value.

The ability to appeal to profit and loss gives entrepreneurs the information, incentive, and calculational process to act in accordance with social values, both externally from their business to others across the structure of production, and internally as a way to continuously check operations within their firm. Entrepreneurial activity can, therefore, penetrate into the firm's internal operations. Mises says:

> Business management or profit management is management directed by the profit motive. The objective of business management is to make a profit. As success or failure to attain this end can be ascertained by accounting not only for the whole business concern but also for any of its parts, it is feasible to decentralize both management and accountability without jeopardizing the unity of operations and the attainment of their goal. Responsibility can be divided. There is no need to limit the discretion of subordinates by any rules or regulations other than that underlying all business activities, namely, to render their operations profitable.[13]

The test of profit and loss applies not only to the firm vis-à-vis the market, but also within the firm as entrepreneurs use it to check the viability of internal operations. Thus, entrepreneurial activity has full reign both within firms (via both general and specialized entrepreneurship) and across firms (via specialized entrepreneurship) firms in a market system.[14]

While the process of exchange and production is driven by entrepreneurs, its goal is the satisfaction of the subjective values of those who participate as consumers and owners of factors of production. And thus, it is also a continuing testing ground for the selection of

[13]Ludwig von Mises, *Bureaucracy* (Cedar Falls, Iowa: Center for Futures Education, [1944] 1983), pp. 45–46.

[14]The need to check the profitability of each internal operation of the firm requires money prices that can only be determined by the buying and selling of those outside the firm. Thus, in capitalism if a firm grew to encompass the entire market, entrepreneurs would no longer be able to apply economic calculation to its internal operations. This is *the* economic problem of socialism. See Rothbard, *Man, Economy, and State*, pp. 544–50.

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specialized entrepreneurs who best fulfill its goal. Those who cannot consistently earn profits and avoid losses will be weeded out from the ranks of specialized entrepreneurs, as capitalists, seek to provide funds to those who produce for them the highest returns.

The Role of Entrepreneurship in a Socialist System

Since social production requires the coordination of numerous, diverse individuals all engaging in human action, every social system must have channels for entrepreneurship. Social production cannot exist without entrepreneurship but each economic system opens different channels to it and opens them to different degrees. In the free market all channels are open to entrepreneurship within the boundaries of private property ownership and voluntary exchange. In socialism with state ownership of the means of production and legal prohibition of voluntary contracts, entrepreneurship is severely repressed and misdirected as its social functions are encroached upon by coercion and bureaucracy. Within the framework of the central plan, entrepreneurship takes on a peripheral role. Instead of being the driving force behind social production it becomes the means of coping with the contradictory and impossible demands of the plan. And yet, the ability of entrepreneurship to satisfy its social functions cannot be eradicated, a fact partially responsible for the economies of communist countries continuing to limp along year after year, providing their long-suffering citizens a meager standard of living.[15]

By eliminating private property and voluntary exchange, socialism eliminates money and money prices, and thus economic calculation and with it rational production. The planners not only cannot determine the relative scarcities, i.e., social value, of consumer goods, they have no meaningful way to choose among the various production techniques available to create the (socially) arbitrary list of consumer goods they have selected. They cannot rationally arrange a division of labor, lacking as they do information, incentives, and a calculational process. Under such conditions it becomes extremely difficult,

[15]For the most recent exposé on the suffering of the Soviet citizen, see Paul Craig Roberts and Karen LaFollette, *Meltdown Inside the Soviet Economy* (Washington, D.C.: Cato Institute, 1990), pp. 39–74. They report Mikhail Gorbachev himself publicly announcing in 1988 that the Soviet economy had not grown for twenty years (p. 1). Coupled with the fact that the Soviet citizen's standard of living lags behind that in many Third World countries (p. 5) the truth of the dismal failure of Soviet attempts at central planning is evident. For similar accounts of the Hungarian and Peruvian citizens respectively, see Ivan Szelenyi, *Socialist Entrepreneurs* (Madison: University of Wisconsin Press, 1988); and Hernando de Soto, *The Other Path* (New York: Harper & Row, 1989).

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if not impossible, for the planners to exhibit entrepreneurship even if one assumed that they had comparative advantage in it.[16] Encompassed within the "single factory" that the economy becomes under socialism, the amount and accuracy of entrepreneurial insight are greatly diminished, severely hampering the social functions only entrepreneurs in the performance of their social functions.

Being planned from the top, the structure of production in a socialist economy must be simple and rigid vis-à-vis a capitalist economy since every production process in every stage of production must be written down and coordinated by the small group of planners.[17] This process parallels what a specialized entrepreneur does within his business firm in planning internal operations, which illustrates why such a plan must be almost infinitely more simple than the entire free market production structure encompassing, as it does, all the insight and plans of every entrepreneur across all businesses. Socialism formally taps the entrepreneurial skill of only the central planners while capitalism formally provides a channel for the entrepreneurial insight and energy of everyone, either in a specialized role or generally, i.e., in every action.

The absence of private property and voluntary contract also nearly eliminates the ability of (potential) entrepreneurs, within the "single factory," to assume the uncertainty of social production by becoming residual claimants. They are thus, unable to fulfill their social role in production or provide a testing ground to discover who has comparative advantage as specialized entrepreneurs. Instead, those involved in the process of production from the higher stage capital goods through to the lower stage capital goods and finally to the consumer goods become creatures of the bureaucracy. The central planners and bureaucrats issue orders, backed by coercion, to achieve production goals and thus, must rely on bureaucratic management, instead of profit and loss management, for fulfillment of the plan.

Mises defines bureaucratic management as, "the method applied in the conduct of administrative affairs the result of which has no cash value on the market," or "management of affairs which cannot

[16]The presumption would be quite the opposite; that those who rise to the top in the political process have comparative advantage in the skills needed to do so and not superior forecasting of future subjective values of others or propensity for accepting the burden of uncertainty. See F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944), pp. 134–52.

[17]For examples of how inferior the structure of production is in the Soviet Union, see Roberts and LaFollette, *Meltdown*, pp. 7–37. The contrast between the smooth operation within a capitalist firm and the chaos within the socialist "single factory" is remarkable.

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be checked by economic calculation."[18] Lacking the method of economic calculation, bureaucrats cannot exhibit entrepreneurship to any significant degree. Mises says:

> Bureaucratic management is management bound to comply with detailed rules and regulations fixed by the authority of a superior body. The task of the bureaucrat is to perform what these rules and regulations order him to do. His discretion to act according to his own best conviction is seriously restricted by them.[19]

Bureaucracy places so many fetters on producers that most entrepreneurial activity is done illegally, some to nominally fulfill the plan, some to subvert it.[20]

Mises concludes:

> Socialism, that is, full government control of all economic activities, is impracticable because a socialist community would lack the indispensable intellectual instrument of economic planning and designing: economic calculation. The very idea of central planning by the state is self-contradictory. A socialist central board of production management will be helpless in the face of the problems to be solved. It will never know whether the projects considered are advantageous or whether their performance would not bring about a waste of the means available. Socialism must result in complete chaos.[21]

No country in history has ever fully adopted socialism since it would mean swift death for its population. Instead, socialist countries play at central planning, overlooking widespread violations of the plan and using prices on international markets to engage in calculation.[22]

A Policy of Desocialization Accounting for Entrepreneurship

To provide for the full expression of the creative energies of entrepreneurs, the former communist countries must fully desocialize their economies by privatizing all property and removing the fetters of government intervention.[23, 24] Complete desocialization requires putting

[18]Mises, *Bureaucracy*, pp. 47–48.

[19]Ibid., p. 45.

[20]For fascinating examples of the native entrepreneurship of the Soviet people tragically suppressed by the bureaucracy see Roberts and Lafollette, *Meltdown*, pp. 7–37.

[21]Mises, *Bureaucracy*, p. 57.

[22]For Soviet examples of this phenomenon see Roberts and LaFollette, *Meltdown*, pp. 9, 15–17, and 25–26.

[23]As in all cases where property ownership is concerned, desocialization raises ethical as well as economic questions. It is not surprising that the program of complete privatization not only creates the necessary point of departure for the free market but

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full ownership (control of use in action including voluntary contract) of labor, land, and capital into the hands of individuals. With labor, this is relatively simple. Since each person naturally owns his labor it requires only that government interventions restricting the use of labor be abolished, allowing each person to freely contract and associate with others. Self-ownership and freedom of contract are necessary prerequisites of a completely entrepreneurial economy because entrepreneurship is an individual phenomenon and can only be expressed socially, by individuals, in the less-than-fully predictable process of earning profit and avoiding loss. Entrepreneurship cannot be centrally planned, either in specific decisions or personnel.

The initial ownership of land and capital is not as easily implemented but theoretically should follow the principle of homesteading since it in turn is derived from the principle of each person owning his labor. The application of homesteading to existing unjustly owned, i.e., state owned, property is a syndicalist strategy; that is, land to the farmers and capital to the workers.[25] The labor of those who have worked the land under the collective ownership system gives them sufficient claim to the land to supersede the claims of others, save those who could demonstrably justify, i.e., by homesteading or contract, their ownership prior to state confiscation. Each parcel of land should be returned to those peasant farmers who worked it under collectivization. Likewise the ownership of capital should initially be given to those who worked in the various state-owned factories.[26]

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is morally justified as well. This is a corollary of the principle that selfownership and homesteading are the prerequisites of the free market. For the ethical justification of the free market see Murray N. Rothbard, *Ethics of Liberty* (Atlantic Heights, N.J.: Humanities Press, 1982); Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism* (Boston: Kluwer Academic Publishers, 1989); and Hans-Hermann Hoppe, "From the Economics of Laissez Faire to the Ethics of Libertarianism," in Walter Block and Llewellyn H. Rockwell, Jr., eds., *Man, Economy, and Liberty* (Auburn, Ala.: Ludwig von Mises Institute, 1988).

[24]Far from despoiling these formerly communist countries with crass Western materialism, the implementation of capitalism will allow each group of people to fully express its own unique culture in ways restricted and forbidden until now. Indigenous entrepreneurs will bring forth those consumer goods, and the capital goods most suited for producing them, that people find desirable within the constraint of their cultural norms.

[25]See Hans-Hermann Hoppe, "De-Socialization in a United Germany," *The Review of Austrian Economics* 5, no.2 (Fall 1991): 98–104.

[26]As a practical matter, this would probably need to include the former bureaucrats who presided over the production centers. Although those remote from the source of production, i.e., central planners, would only have homesteading rights to the particular state buildings they used in their former endeavors. On what to do with the bureaucrats, see Murray N. Rothbard, "How to Desocialize?", *The Free Market* 7, no. 9 (September 1989).

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Privatizing property would significantly reduce the size of government, eliminating state production and provision of goods and the massive bureaucracy necessary to operate the state apparatus. In its place, specialized entrepreneurs would emerge as those who render the greatest returns to the initial owners of land and capital as these owners sought out investment in entrepreneurial ventures. This voluntary method of capitalizing the specialized entrepreneurs is the only one consistent with the property ownership and freedom of all individuals. Simultaneously, it elicits the greatest quantity and quality of social entrepreneurship.[27]

The privatizing of socialist production centers should be done by creating ownership shares and distributing them to the workers at each center. Alternative schemes for privatizing these centers have either economic or ethical defects or both. For example, having a national auction where the state sells all state-owned property is grossly unjust: akin to having slaves pay their masters for the "privilege" of their freedom. Since the state is an illegitimate confiscator of property it has no just claim to sell or even use the property it has appropriated. If anything, justice demands that state officials compensate the populace for the decades of virtual enslavement under their communist regimes. A national lottery to give away all state property cannot satisfy the demands of justice either. By what right can those who have not attached their labor to the capital and land make a superior claim to those who have? There is no justice in a random distribution of previously homesteaded and then expropriated property. Finally, a scheme to inventory all state property and issue equal ownership shares to each person fails on both economic and ethical grounds. Justice demands that ownership of capital and land be objectively identified with those who transformed this property with their labor, and economic ownership requires that the individual be able to sell his shares or liquidate them

[27]While there is a tendency on the free market for those individuals to emerge as specialized entrepreneurs who have the relevant comparative advantage regardless of the existing pattern of property ownership, the precise outcome of social production will not be identical under different patterns of initial ownership. The beginning distribution of capital and land must take into consideration the question of justice. If not, one should argue for the most expedient pattern of ownership; i.e., leave it in the hands of the bureaucrats and central planners. That such a suggestion is immediately ruled out is proof that justice makes a difference and must be appealed to unless the program of desocialization be discredited and abandoned. The tendency for efficient selection of specialized entrepreneurs on the market is actually an argument in favor of privatizing according to selfownership and homesteading principles. Since the general economic result will be similar with either an unjust pattern of initial ownership or a just one, the latter is preferable.

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in specific pieces or limited aggregates of property. This ability is the counterpart to that of entrepreneurs who in creating new business firms could issue and initially sell shares only in their own firms. If they cannot do this they do not fully own their firms. These private shares would quickly out-compete the inefficient collective ownership shares, which would eventually be divided into economically meaningful sub-components, like shares for each private business firm, or become worthless.[28]

Essential to the justice and economic success of such privatization would be free trade in these shares. The newly born stock market would quickly expand as emerging specialized entrepreneurs form new businesses and begin, with free capital markets in general, to correctly channel savings into the structure of production and across the structure to various processes for creation of the necessary capital goods without government intervention injecting irrationality into the process.

Money must also be returned to the market by state decrees to end monetary inflation immediately, to make the official currency redeemable in gold (at a rate appropriate to allow redemption of the entire stock of fiat paper for the state's gold stock), and to allow entrepreneurs to freely produce money within the framework of property rights. Returning money to the market is necessary to meaningful economic calculation without which rational social production cannot occur. Allowing the state to maintain control of money, even partial, insures the distortion of entrepreneurial activity as the state uses this power to control spending and capital flows.[29]

Privatization should be instituted simultaneously with a complete dismantling of all forms of government intervention into the ensuing pattern of voluntary exchange and division of labor. This is a necessary condition of permitting private property ownership and of opening the channels for entrepreneurial activity in social production. With no more interference into the contractual conditions of private individuals, e.g., no price controls or occupational licensing, government would be further scaled back, releasing more bureaucrats into the productive private sector.

[28]For a discussion of these alternatives, see Hoppe, "De-Socialization," pp.98–101.

[29]On the gold standard see, Murray N. Rothbard, "The Case for a Genuine Gold Dollar," in Llewellyn H. Rockwell, Jr., ed., *The Gold Standard: An Austrian Perspective* (Lexington, Mass.: Lexington Books, 1985); and idem, "The Case for a 100 Percent Gold Dollar," in Leland Yeager, ed., *In Search of a Monetary Constitution* (Cambridge, Mass.: Harvard University Press, 1962).

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Finally, the process of desocialization should be done instantly, following the historic example of the German economic "miracle" begun by Ludwig Erhard on June 24, 1948.[30] Halfway measures will not work since they create secondary problems and the ensuing political pressure to renew controls.[31]

No better example of this principle exists than the tragic plight of the people of the former East Germany who may miss this historic chance for freedom by their apparent acceptance of the West German welfare state instead of a free market.[32] The results so far have been massive transfers of wealth from west to east caused by the artificial overvaluation of the East German mark; unjust property ownership caused by the sale of state assets and the preference in these sales to the politically connected; unemployment caused by the adoption of unemployment "insurance" and minimum wages; inefficient allocation of capital caused by acceptance of social security; inefficiencies and wealth destruction caused by implementation of a West-German-style tax structure and controls interfering with free domestic and international trade. Such a welfare-statist beginning does not bode well for the freedom and prosperity of the German people.

The East Germans would have been far better off traveling a course of complete privatization, not only for themselves, but for the irresistible pressure thereby put on the West German state to follow them down the privatization path. Unfortunately, they, like most people, have a dearth of principled, courageous, and knowledgeable statesmen who would take the initially, politically difficult path. Instead they are led by politicians willing to import the disastrous welfare-statist policies and politicians of West Germany.[33]

Entrepreneurship has no direct role in bringing about the program of desocialization. However, entrepreneurial activity has played a crucial indirect part by subverting the centrally planned system, illustrating to people the benefits of freedom. Those in the political system with the courage to desocialize will face their biggest obstacle in the bureaucracy, entrenched as it is in the status quo. Overcoming this obstacle will be a most difficult political problem; those who will

[30]Consider also the Russian economist Yuri Maltsev's one-day plan for the immediate desocialization of the Soviet Union outlined in, "The Maltsev One-Day Plan," *The Free Market* 8, no.11 (November 1990). A similar, but relatively snail-paced, plan for the United States is outlined by Llewellyn H. Rockwell, Jr. in, "Rockwell's Thirty-Day Plan," *The Free Market* 9, no. 3 (March 1991).

[31]See Mises, *Human Action*, pp. 858–61.

[32]See Hoppe, "De-Socialization," pp. 90–95.

[33]Ibid., pp. 88–97.

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take the unpopular course of instant desocialization are not political entrepreneurs but statesmen to whom their countrymen would owe a great debt of gratitude.[34]

Conclusions

Entrepreneurship is the driving force behind improving the ability of all people to attain their ends in cooperation with one another. The future condition of mankind depends on the channels provided within a social system for the functioning of entrepreneurship. To have the greatest amount of entrepreneurship of the highest quality, a social system must be based on the private ownership of property and individual liberty. Only then can the free market emerge incorporating the talents of everyone in a voluntary, cooperative edifice of exchange and production coordinated by entrepreneurship which is made possible by economic calculation. A rare moment in history has come, allowing countries of the world to institute the free market, and thus ensure the prosperity and gratitude of their progeny.

[34]Adherence to the Misesian view of entrepreneurship avoids the paradoxical idea of the "political" entrepreneur. The specialized entrepreneur, by definition, is involved in the wealth-enhancing process of voluntary cooperation within the division of labor where everyone benefits. There can be no "political" entrepreneur since the political process employs coercion resulting in the transfer and destruction of wealth as it distorts the division of labor. There is, however, political entrepreneurship in the sense that in every action the actor must deal with uncertainty. In the political arena this would be akin to the entrepreneurship interest in the actions of the robber and swindler. In both cases, the actor is uncertain concerning how much he can take from the victims and how strong and in what form their resistance might be. For analysis using the concept of a political entrepreneur, see Gordon Tullock, *The Politics of Bureaucracy* (Washington, D.C.: Public Affairs Press, 1965), pp. 99f; and James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1965), pp. 334f.

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Review Essay

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Aurophobia: or, Free Banking on What Standard?

Murray N. Rothbard*

Gold, Greenbacks, and the Constitution. By Richard H. Timberlake. Berryville, Virginia: The George Edward Durrell Foundation, 1991.

In recent years, disillusionment with the record of central banking has led a number of economists to return to the nineteenth-century concept of "free banking": [t]hat is, free and unregulated banking without a central bank. Unfortunately, this return has not been toward the Currency Principle/Mises tradition of free banking *within* a firm matrix of demand liabilities (notes or deposits) grounded in 100 percent reserves in specie (gold or silver). Instead, this new movement has harked back to the contrasting inflationary credit generated by what used to be known as "wildcat banking." In lauding free banking as akin to a free market in any other good or service, these new free bankers have overlooked two vital defects. First, that a genuine free market must be based on an absence of fraud or theft, whereas issuing demand liabilities in excess of assets is equivalent to a warehouse issuing fraudulent receipts to non-existing assets, and is therefore a species of fraud or embezzlement. And second, the free bankers neglect the insight of Currency Principle men from Ricardo down, that all quantities of money are optimal, and that therefore—in stark contrast to all other goods—increased supplies of money can only be redistributive and can confer no social benefit.[1]

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[1]With the exception, of course, of increased *non*-monetary benefit from an increase in gold or silver, a gain that cannot accrue from an increase in fiat paper or in fractional-reserve bank credit.

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On the first point, we contend that bank notes or deposits are bailments and not debt, and that therefore an issue of fractional reserve liabilities can only be a violation of the bailment contract. In addition to the pressure of bankers on the law, one of the reasons why the critical court decisions in the nineteenth century ruled the other way is that bailment law was then in an undeveloped state. In the late nineteenth century, and even in the 1930s in the United States, grain warehouses, which, as in the case of banks, issue warehouse receipts to fungible goods, were able to issue, unchecked and unpunished, fraudulent receipts to non-existent wheat, which they loaned out to speculators in the Chicago wheat market. Interestingly enough, this fractional-reserve process generated a local boom-bust cycle in Chicago wheat.[2] In a genuinely free market, absent force or fraud, bank loans or investments would reflect only their own equity or their genuine debt (e.g., bonds or certificates of deposit), which would constitute genuine credit transactions—exchange of a present good (e.g., money) for a future good (e.g., money at a future date). Free marketeers are sometimes in danger of forgetting that fraud or robbery can be committed by private organizations as well as by government. As Mises favorably quoted Thomas Tooke, "free trade in banking is free trade in swindling."[3]

On the second, more narrowly economic point, from Ricardo to Mises and his followers it has been demonstrated that an increase in the money supply can only dilute the effectiveness of each existing money unit, and therefore must be "inflationary" in the sense of raising prices beyond what they would have been otherwise. In addition, we know from Mises's theory of the business cycle that such inflationary bank credit can only lead to a destructive boom-bust business cycle. And it is not true, on Misesian theory, that central banking is necessary in order to generate this cyclical process. Any bank credit expansion in commercial loans is sufficient to generate the business cycle, whether a central bank exists or not. In the Misesian view, however, there will tend to be far more room for bank credit expansion whenever a central bank, with its privileging by

[2]Ours is the view of the losing counsel in the 1816 English case of *Devaynes v. Noble*, who argued that "a banker is rather a bailee of his customer's funds than his debtor . . . because the money in . . . [his] hands is rather a deposit than a debt, and may therefore be instantly demanded and taken up." See J. Milnes Holden, *The Law and Practice of Banking, Vol. 1: Banker and Customer* (London: Pitman, 1970), p. 31; Murray N. Rothbard, *The Mystery of Banking* (New York: Richardson & Snyder, 1983), pp. 87–95.

[3]Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, 1963), p. 446.

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government and its role as a lender of last resort, is active in the economy.

The recent free bankers have consisted of a coalition of ex-Misesians (White, Selgin, Glasner), English subjectivists (Dowd), and neo-monetarists or neo-Friedmanites (Yeager, Timberlake). Friedman himself, while not totally committed to free banking, has been indicating his disillusion with the Fed's failure to follow his famed Money Rule (in addition to the increasing monetarist difficulty in figuring out which of the various Ms should be subject to that Rule). Hayek may be added to that list, except that he was never a Misesian on this question, at least since the 1930s.

I do not propose here to rehash the substantial controversy between the modern free bankers and the modern Misesians (Rothbard, Salerno, Hoppe, Skousen, North), much less discuss the older 100 percent tradition (most eighteenth-century British economists, including Hume, except Adam Smith; the Currency school; the Jeffersonians and Jacksonians), or the 100 percent fiat paper reserve tradition of the Chicago school (Fisher, Knight, Simons, Hart, and the early Friedman). What I want to do here is to focus on another vitally important, but neglected, area of the free-banking controversy. Assuming for the sake of argument that banks will be free without restrictions to issue demand liabilities to standard money, *what*, in the view of the free bankers, is that standard money supposed to be? In a sense, this problem is more important and fundamental than the question of the reserve ratio: What is money, and what is going to be the "standard" money, in which these liabilities are supposed to be redeemable on demand?[4]

Oddly enough, the answer to this vital question by the free bankers have been vague, murky, and inconsistent answers that reveal deep and unexamined flaws in the free-banking camp. The recent booklet by Professor Timberlake—in the same vague and murky tradition—provides us with an opportunity to examine the views of modern free bankers on the monetary standard, and on what exactly would constitute the "cash" upon which the banks would be allowed to pyramid as many demand liabilities as they could get away with.[5]

[4]In 1975, at least, Hans F. Sennholz, a former Mises student, had no doubt on the proper answer to this question, as note the title of the book he then edited: *Gold I$ Money* (Westport, Conn.: Greenwood Press, 1975). Since then, however, Sennholz has apparently become an ex-Misesian and joined the free-banking camp.

[5]Hayek's proposal, which can only be considered grotesque, can be dismissed quickly. For Hayek would solve this problem by having each bank create its own fiat paper currency. In short, a Rothbard Bank could issue notes or deposits in 50, 100, and

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Professor Timberlake's work is a curious performance. Ostensibly, it is a brief history of the greenbacks and of the judicial controversy over the constitutionality of the greenbacks and of their legal tender powers. Much of Timberlake's discussion of the Legal Tender Cases is indeed illuminating, since Timberlake is squarely opposed to the constitutionality of fiat money. And yet there are curious distortions and overtones, which build to a climax in the concluding chapters when Timberlake reveals his own positive monetary proposals. For one thing, his attack on greenbacks would seem to imply a pro-gold standard position, and yet throughout his analysis there is a subtle but continuing disparagement of gold which becomes evident when he unrolls his own inflationist, fiat money program. Thus, Timberlake states that the gold standard only existed for four decades in the nineteenth century, omitting the crucial point that from time immemorial only two standard moneys existed, gold and silver, with confusion only emerging from the co-existence either of parallel standards, in which gold or silver were free to fluctuate, or bimetallic standards, in which governments attempted to fix the gold/silver at a ratio varying from the market. The fact that gold monometallism existed for only a few decades is beside the point, which is the well-deserved monetary longevity of both gold and silver.

Furthermore, while critically analyzing the judicial defenders of greenbacks, Timberlake manages to focus the issue almost exclusively on the illegitimacy of government power to make greenbacks, or fiat paper, legal tender for private contracts. But the power to make paper legal tender for payments *to government* is left unscathed by Timberlake, which as we shall see seems to fit into his ultimate monetary agenda. This omission contrasts starkly with the magnificently hard-money Jacksonians, who endeavored to end the federal government's power to receive paper or deposits in taxes or fees. The Jacksonians tried, and partially

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1,000 Rothbards, which would be redeemable in . . . the same amount of paper Rothbard tickets! Such a bank could of course never fail, but it is doubtful if anyone save close friends and relatives could ever be induced to use and hold these notes and deposits, regardless of what grandiose promises about "price stability" Rothbard might wave in front of potential customers. In addition, Hayek's proposal is absurdly "constructivist" on his own methodological terms. It is doubtful that anyone not a Nobel Laureate making such a proposal would be taken seriously. Thus, see F. A. Hayek, *Denationalisation of Money* (2nd ed., 1976; London: Institute of Economic Affairs, 1978). For a critique, see Murray N. Rothbard, "The Case for a Genuine Gold Dollar," in Llewellyn H. Rockwell, Jr., ed., *The Gold Standard: An Austrian Perspective* (Lexington, Mass.: D. C. Heath/Lexington Books, 1985), pp. 2–6.

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succeeded, in limiting the government to accepting only specie in payments.[6]

Once curious aspect of Timberlake's anti-gold stance is to embrace Milton Friedman's new-found attachment to bimetallism. Timberlake actually refers to Gresham's Law as demonstrating the gently stablizing effects of bimetallism (pp. 8–9). And yet one of the more valuable insights of monetarism was to demonstrate that fixing of exchange rates inevitably causes distortions by creating shortages of the undervalued, and surpluses of the overvalued, money. From the fourteenth-century French scholastic Nicole Oresme to Ludwig von Mises, Gresham's Law has been seen as the inevitable and unfortunate consequence of maximum price control for the undervalued money and of minimum price control for the overvalued. And yet in pursuit of his lifelong hatred of gold, Milton Friedman seems willing to embrace virtually any alternative, including bimetallism, and Timberlake is willing to follow suit.

Part of Timberlake's problem here is thinness of scholarship. Thus, he discusses the central role of Civil War Secretary of Treasury (and later Chief Justice) Salmon P. Chase, without bothering to mention the national banking system, or Chase's intimate corruptionist connection with the investment banker Jay Cooke. He mentions Chase's ambition, and notes with surprise that Chase wanted to run on the Democratic ticket in 1868, without realizing that Chase was an old Jacksonian Democract, and with slavery defeated there was every reason for him to return to the Democracy. More important, Jay Cooke was an old friend and literal patron of Chase, and Cooke and his influential Ohio journalist brother Henry lobbied the Lincoln Administration heavily and effectively to make their client Chase Secretary of the Treasury. As soon as Chase gained the post, Cooke easily persuaded Chase to grant him the unprecendented power of monopoly underwriter of all government bonds—a monopoly Cooke was able to retain, almost unbroken, until he went bankrupt in the Panic of 1873. Then, Chase went along with Cooke's plan to destroy the decentralized pre-Civil War banking system and to replace it with a quasi-monopoly National Banking System, a system in which the federally chartered national banks

[6]The Jacksonian Democrats, under Van Buren and Polk, were able to impose the Independent Treasury sytem, in which the federal government kept its money only in its own Treasury vaults, and not in any banks. They did not succeed, however, in requiring the government to accept taxes and fees only in specie. See Major L. Wilson, *The Presidency of Martin Van Buren* (Lawrence, Kans.: University Press of Kansas, 1984), pp. 61–121.

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had a monopoly privilege to issue notes, and their note issue was based *pro rata* on how many government bonds they might purchase. The bonds, of course, had to be purchased from Jay Cooke, who also managed to have himself granted several national bank charters. And so, when Timberlake refers crossly to Chase's "patent . . . anti-bank prejudice" (p. 21), he neither seems to understand that that "prejudice" stemmed from Jacksonian hard-money principle, nor that Chase stood ready to violate that principle in behalf of his corruptionist patron Cooke and so created the national banking system.

And while Timberlake correctly notes that the Republicans in this era were inflationist while the Democrats favored gold and hard money, he fails to link up these positions with economic interests. One of the major forces in favor of greenback inflation was the iron and steel industry, centered in Pennsylvania. Under the leadership of the Pennsylvania economist and ironmaster Henry C. Carey, the Radical Republicans and iron and steel interests were instructed that falling dollar rates caused by greenback inflation acted as a temporary but welcome extra tariff, discouraging iron and steel imports and encouraging their export. The other major inflationist interest was the big railroads, the major big businesses and incorporated enterprises in the country. Heavily indebted to their bondholders, the railroads saw that inflation would lower the real value of their outstanding debts. Thus, Timberlake correctly notes the significance of the action of the Grant Administration in appointing two Supreme Court Justices to fill vacancies. The Administration was sure these judges would quickly reverse the Legel Tender Cases and declare greenbacks and fiat money constitutional. Timberlake notes that these two swing justices were William Strong and Joseph P. Bradley, but fails to make the important point that Strong had been a top attorney for the Philadelphia and Reading Railroad, and a director of the Lebanon Valley Railroad; and as for Bradley, his connections with the railroad interests were almost as great, having been a director of the Camden and Amboy Railroad and of the Morris and Essex Railroad, both in New Jersey.[7]

One pervading problem is that Timberlake's scholarship is spotty. Thus, on the post-Civil War monetary situation, there is reference to Irwin Unger's *The Greenback Era*, but no mention whatever of the equally important Robert P. Sharkey, *Money, Class and Party: An*

[7]Ron Paul, *The Ron Paul Money Book* (Clute, Texas: Plantation Publishing, 1991), pp. 115–16. On the railroad ties of Strong and Bradley, see Philip H. Burch, Jr., *Elites in American History, Vol. II: The Civil War to the New Deal* (New York: Holmes & Meier, 1981), pp. 44–45.

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Economic Study of Civil War and Reconstruction (Baltimore: Johns Hopkins University Press, 1959). Timberlake mentions Bray Hammond's classic *Banks and Politics in America*, but overlooks Hammond's important *Sovereignty and an Empty Purse: Banks and Politics in the Civil War* (Princeton: Princeton University Press, 1970). He uses the splendidly hard-money Don C. Barrett's article in the *Quarterly Journal of Economics* (May 1902), but omits Barrett's fully developed book, *Greenbacks and the Resumption of Specie Payments, 1862–1879* (Cambridge: Harvard University Press, 1931). And how can anyone, as Timberlake does, deal with silver and bimetallism without so much as mentioning the famed revisionist article by Paul M. O'Leary, "The Scene of the Crime of 1873 Revisited: A Note," (*Journal of Political Economy* 68 [1960]: 388–92), or the splendid work by Allen Weinstein, *Prelude to Populism: Origins of the Silver Issue 1867–1878* (Yale University Press, 1970)?

Perhaps the problem is that Professor Timberlake, or his Durrell Foundation editor, John W. Robbins, was anxious to rush past the history to get to the policy conclusions, the monetary agenda which is only loosely based on the preceding historical discussion. In his conclusion, Timberlake brusquely dismisses the gold standard. Gold, he says, has been subject to government manipulation by central banks. Very true, but how about the gold standard that also abolished the central bank? This Misesian solution is not mentioned, nor indeed is the extensive Jacksonian literature to the same effect. Timberlake states as if a new point that under the gold standard government need not have minted gold coins, a theme that has long been part of the Misesian literature. He need scarcely rely for reference on a forthcoming article by J. Huston McCulloch. Timberlake only bothers making two other negative references to justify his dismissal of gold. One, that gold might "shut out technically more efficient systems" (p. 52), whatever they might be, but without pointing out that efficient clearing systems can be and have been based on standard metallic money. His other point is the disingenuous one that even Ludwig von Mises, a champion of gold, admits that gold "introduces an incalculable factor into economic activity" (p. 47). But Timberlake fails to note Mises's very next point: that this incalculable factor, stemming from variations in the supply of gold, has been minuscule compared to the volatility introduced by government and by bank manipulations of the supply of money.[8]

[8]Ludwig von Mises, *The Theory of Money and Credit* (1934; Indianapolis, Ind.: Liberty*Classics*, 1980), p. 27.

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What then is Professor Timberlake's proferred alternative, one which he avows would "more effectively constrain the state" than the gold standard (p. 52)? What, in Timberlake's words, "is a market-directed monetary system completely free from any possible government intervention" (p. 62)? Or to return to our earlier question, in Timberlake's proposed world, in what thing would banks liabilities be redeemable? The one cogent note in Hayek's bizarre "denationalized currency" scheme is the pungent clarity of his answer: banks that issue Hayek, Rothbards, and ducats would redeem these paper tickets or open book liabilities in Hayeks, Rothbards, and ducats. Timberlake, unfortunately, is not nearly so clear. He does seem to realize that Americans are stuck with "dollars" as their currency unit and standard, just as Englishmen are stuck with pounds and Germans marks. He does not, however, explain why these countries are necessarily stuck with currency names. Instead, he becomes even murkier by adopting the curious—and grotesquely "constructivist"—plan of Greenfield and Yeager: that the monetary unit of account be totally and ineluctably sundered from the medium of exchange. The monetary unit would still be the dollar, but how then is the "dollar" to be defined? Originally, the dollar, along with every national currency, was simply defined as a definite unit of weight of gold or silver. Before 1933, for example, the "dollar," the monetary standard in the United States, was defined as 1/20 of an ounce of gold. Nowadays, of course, the "dollar" is fiat; it is simply a paper ticket issued by the Federal Reserve System that says, on its face, "one dollar" or "ten dollars."

What would Timberlake do about this; or, following Greenfield and Yeager, how would he proceed to "the practical purpose of getting the government [in the guise of the Federal Reserve System] out of any policy-making role" (p. 60)? By severing the dollar from the medium of exchange. The government would define the "dollar" as equal "to a market price index made up of a limited array of staple, conventional, basic commodities—items that would ideally mirror an all-markets average of prices." But if the government defines the dollar as an overall price index, wouldn't this definition be subjected to political pressure for continually redefining the index; and wouldn't the government almost automatically strive to stabilize the price level as gauged by its precious index? No, because incredibly, according to Timberlake, Greenfield and Yeager, the government would be sternly advised *not* to stabilize its own index. But does anyone in his right mind, anyone at all familiar with our political system, think for one moment that the government would thus keep its hands off its own index?[9]

[9]Professor Timberlake would have done well to heed Mises's insights about index numbers in the passage just before the sentence he yanked out of context: "If it should

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And what, too, would be the medium of exchange in Timberlake's system, and would that medium be redeemable in the dollar-index? None of that is clear. If it is redeemable, then presumably people would not be walking around with index market-baskets; if instead, it is to be redeemable in the "purchasing power" of the index, then we are back to stabilizing the price level, and also in *what* would the medium be redeemed, and would that index then become the medium? If not, and if there is to be no redemption whatever, then who is to supply the medium of exchange, and what is to keep the "free" money suppliers from issuing money *ad infinitum*? (In the gold standard, of course, what keeps the banks at least partially in check is the necessity to redeem in gold.) Timberlake is of little help in supplying this crucial answer.[10] At one point he refers to the "medium of exchange [as] the Federal Reserve note" (p. 60)! *That's* getting the government and the Fed "out of any policymaking role?" At another point, he inconsistently "would leave this function [supply the quantity of money] to dealers and arbitrageurs in financial and commodity markets" (p. 60). What is all this supposed to mean? At another point, the confusion is even worse compounded by Timberlake's calling for "privatizing" the government's gold stockpile "and the twelve Federal Reserve Banks" (p. 62). Privatizing the Federal Reserve? What can this mean? In a profound sense, the Federal Reserve, as well as all previous central banks, are already "private"—a government-established and enforced cartel of the private banking

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be thought that index numbers offer us an instrument for providing currency policy with a solid foundation and making it independent of the changing economic programs of governments and political parties, perhaps I may be permitted to refer to what I have said. . . . on the impossibility of singling out any particular method of calculating index numbers as the sole scientifically correct one. . . . There are many ways of calculating purchasing power by means of index numbers, and every single one of them is right, from certain tenable points of view; but every single one of them is also wrong. . . . Since each method of calculation will yield results that are different from those interests and injure others, it is obvious that each group of persons will declare for those methods that will best serve its own interests." Mises, *Theory of Money and Credit*, pp. 26–27. Also see Mises's scintillating critique of index numbers in ibid., pp. 215–23.

[10]Greenfield and Yeager are not much more helpful either. In contrast to Timberlake's hint about "privatized" Federal Reserve notes still constituting the medium of exchange, Greenfield and Yeager avow the absence of "any dominant" medium of exchange, which seems close to calling for no general medium of exchange at all, and hence a return to some form of barter. Greenfield and Yeager also propose a convenient new criterion for the advance of science: that the burden of proof to clarify and persuade others of a totally new proposal, such as theirs, should rest on the readers bound in their old frameworks rather than on the authors themselves. R. Greenfield and L. Yeager, "Competitive Payment Systems: Comment," *American Economic Review* 76 (Spetember 1986): 848–49.

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system. Are we then to be stuck forever with Federal Reserve notes as "dollars," whether or not they are officially defined as such? Privatizing the Fed is about as cogent, and about as genuinely free-market-oriented, as the idea of "privatizing" the Internal Revenue Service. No, it is important to realize that those government operations which supply or monopolize genuine goods and services should be privatized—e.g., carrying the mail, supplying streets and roads, putting out fires. But other government activities, which are counterproductive and destructive to the market—e.g., the IRS, government regulatory commissions, concentration camps for dissenters—should *not* be privatized but abolished. Surely, that massive monopolistic and inflationary engine of legalized and legitimated counterfeiting called the Federal Reserve System should be abolished rather than privatized.

In supporting the idea of sundering the unit of account from the medium of exchange, Timberlake fallaciously refers to the researches into medieval money of the great economic historian Luigi Einaudi.[11] But he fails to realize that in his historical cases, Einaudi was not writing about an abstract unit of account of "imaginary money" that came from the sky or from professors and was never used as a medium of exchange. On the contrary, in all cases, Einaudi was referring to the bimetallic or parallel metallic situation in which units of weight of gold (or silver) was the medium of exchange in a certain country, whereas units of weight of the other precious metal, silver (or gold) functioned as the unit of account. In this situation, both gold and silver originally emerged, on the market, as media of exchange and hence units of account. Not only do Einaudi's cases not constitute historical support for the Timberlake-Greenfield-Yeager scheme; they are precisely the reverse.[12]

[11]In addition to citing Einaudi's article in the Gayer *Festschrift* for Irving Fisher, Timberlake might have momentarily strengthened his case by referring to the impressive article by Luigi Einaudi, "The Theory of Imaginary Money from Charlemagne to the French Revolution," in F. C. Lane and J. C. Riemersma, eds., *Enterprise and Secular Change* (Homewood, Ill.: Richard D. Irwin, 1953), pp. 229–61. The Einaudi article was originally written in *Rivista de storia economica*, 1936, and its English translation by Giorgio Tagliacozzo was approved and added to by Einaudi.

[12]On the theory of parallel standards, see Mises, *The Theory of Money and Credit*, pp. 205–13. For historical examples of parallel standards, see also W. Stanley Jevons, *Money and the Mechanism of Exchange* (London: Kegan Paul, 1905), pp. 88–96. Robert S. Lopez points out that whereas gold coinage was introduced into modern Europe almost simultaneously in the mid-thirteenth century by Florence and Genoa, Florence instituted bimetallism, whereas "Genoa, on the contrary, in conformity to the principle of restricting state intervention as much as possible, did not try to enforce a fixed relation between coins of different metals." Robert S. Lopez, "Back to Gold, 1252," *Economic History Review* (December 1956): 224.

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The problem with all these plans, from Greenfield and Yeager to Timberlake to Hayek, is that they ignore one of Ludwig von Mises's most original and profound contributions to monetary theory: the "regression theorem," which demonstrates that no money can originate in any society except as a medium of exchange, and as a medium that arose on the free market as a useful non-monetary commodity, e.g., gold or silver.[13] Hence, the regression theorem explains the fallacy and the dismal prospects for all such constructivist schemes as the magic index or the Hayekian ducat. The reason why we must start with the dollar as the money for Americans, the franc as the money for the French, etc., is that the people of these countries are used to those units of account, and since those units grew originally out of a unit of weight of gold or silver, they were useful non-monetary commodities on the market before they became employed as moneys.[14]

If we really wish, then to separate government from monetary policy or from monetary functions, we must totally divest government of those roles. We must therefore start with reality—the dollar defined as a government paper ticket or Fedeal Reserve note—and proceed to privatize the dollar precisely by ending its relationship to the note, and by redefining it as a unit of weight of gold. How is this to be done? By abolishing the Federal Reserve System. Abolishing that "corporation" means, as in the death of any corporation, liquidating its liabilities, and parcelling out the assets of the liquidated organization to its creditors. Since Federal Reserve notes are legally liabilities of the Fed, and since its assets are the Fed's accumulated gold stock kept in Fort Knox and other Treasury repositories, the gold should be parcelled out *pro rata* to the Fed's creditors (holders of

[13]On the regression theorem, see Mises, *The Theory of Money and Credit*, pp. 129–59; *Human Action*, pp. 408–16.

[14]Greenfield and Yeager, dismissing the relevance of the point that their monetary scheme could never emerge from the market, argue that "dismantling government domination of the existing system will require deliberate policy actions, and the positive actions taken will unavoidably condition the successor system." Greenfield and Yeager, "Competitive Payments Systems," p. 849. But it is precisely because economic history is path-dependent that we don't want to foist upon the future a system that will not work, and that will not work largely because such indices and media cannot emerge "organically" from individual actions on the market. Surely, the idea in dismantling the government and return (or advancing) to a free market is to be as consonant with the market as possible, and to eliminate government intervention with the greatest possible dispatch. Foisting upon the public a bizarre scheme at variance with the nature and functions of money and of the market, is precisely the kind of technocratic social engineering from which the world has suffered far too much in the twentieth century.

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Federal Reserve notes and banks that keep demand deposits at the Fed). The dollar would be redefined in units of weight of gold to permit 100 percent liquidation as well as the exchange of gold assets for all liquidated notes and liabilities. As its last monetary function, the Treasury could mint the gold coins out of the deposited bullion to exchange for these notes and deposits. The money supply would then consist solely of gold coins, which could be deposited for warehouse receipts in commercial banks. Federal Reserve notes and deposits would then have disappeared.[15]

One of the few places where I agree with Professor Timberlake's prescription is to "privatize the government's stockpile of gold." But of course legally the gold is owned not by the government *per se* but by the Federal Reserve; and therefore the only way to privatize the gold stock, and at one and the same time to abolish the Federal Reserve and to return from a fiat to a gold standard, would be the plan I have described above: redefinition of the dollar as a unit of weight of gold, and abolition of the Fed and the disgorging of its gold stock, to be exchanged, one for one, for its liquidated liabilities, the Fed's notes and deposits.

I submit that we would then have a gold standard without a central bank, without fiat money, without Federal Reserve notes, and with none of the actualities or even possibilities of government intervention that Professor Timberlake professes to abhor. But for Timberlake, or for Greenfield or Yeager, to adopt such a plan, would require them to abandon once and for all, their flight from gold, that veritable phobia about gold, or "aurophobia," that has marked all respectable schools of economic thought, whether Keynesian or monetarist, for most of the inflationist twentieth century.

[15]What of the government securities that now constitute the bulk of the assets of the Federal Reserve System? An urge for genuine privatization and a decent respect for the taxpayer would require the immediate writing off of these bonds; why should the taxpayer be forced to pay interest and principal when one agency of the federal government owns the bonds of another?

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Book Reviews

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The Enterprise of Law. By Bruce L. Benson. San Francisco: Pacific Research Institute, 1990.

Many advocates of the free market hold an odd view of that institution's scope. Although economists such as F. A. Hayek and James Buchanan laud the market to the skies and never tire of describing the depredations and stupidities of the state, they reverse themselves at a crucial junction.

They maintain that the market depends on the state for its existence. Unless a government establishes and enforces law, they claim, the market will soon sink from order to chaos. It is the outstanding merit of Bruce Benson to subject this view to withering scrutiny, both theoretical and historical. He argues that people can secure justice through private arrangements and that they have often done so, both now and in the past. Far from being necessary to a just social order, the state is a hindrance.

The book should not be taken as a defense of anarchism, since Benson does not discuss functions other than justice such as national defense usually assigned to the state. But in the contemporary climate of opinion, the work is startlingly radical.

If one characterizes law as a system of enforcible rules of conduct, nothing in the nature of law requires its provision by a state. How law has been provided is a question for historical investigation, not one to be resolved by fiat.

Benson clearly gets off to a good beginning. One might add that many eminent legal scholars, most notably John Austin and Hans Kelsen, have defined law in a question-begging way: They require that law be promulgated by a sovereign. Benson, who relies here principally on Lon Fuller, avoids this pitfall.

On one minor point he seems to me incorrect. Why is it the case that if "law is simply represented by any system of rules . . . then

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'morality' and 'law' would appear to be synonymous" (p. 11)? In this definition, what is moral would be legal, but it is not necessary that what is legal be moral.

Benson gives an excellent account of the development of law in Anglo-Saxon England. Custom gave birth to the law and sustained it. The state entered *after* the legal system was developed, seizing control of it in order to gain power and money. His description of the history of English law from Anglo-Saxon times through the nineteenth century shows mastery of a wide variety of sources; his presentation is a veritable *tour de force*. I would suggest only two additions. First, in the description of the Magna Carta, its annulment by Pope Innocent III should have been mentioned. Also, in contrast to the earlier situation described by Benson (p. 68), defendants during much of the nineteenth century could not testify.

The author places great stress on the Law Merchant, which during the period 1000–1200 "evolved into a universal legal system through a process of natural selection" (p. 32). Trade among the nations of Europe took place principally in fairs and markets, and merchants traveled from one to another. They devised a system of courts and regulations to handle business disputes; to rely on the varying customs of each nation would have been grossly inconvenient. This system, formed independently of the various states, became the basis of modern commercial law.

Benson, drawing upon a wide array of data, describes many cases of law without the state, ranging from the Kapauku Papuans of Western New Guinea to the American West in the nineteenth century. Contrary to various Hollywood movies, the West was not a series of never-ending gunfights in which outlaws terrorized a cowed populace. Quite the contrary, the West developed a considerable measure of home-grown law and order (pp. 312–21).

Though these facts cannot be denied, some will be inclined to interpose an objection. Before one can have private arrangements to enforce a body of law, do we not require a structure of rights, in particular an assignment of property titles? How can this structure be created by the market, since for the market to operate rights must first exist?

Benson's reply is cogent. Rights are indeed necessary for a market to function, but it by no means follows that they must be established through collective action. By a mutual recognition of one another's claims, people can gradually build up a system of rights. The market does not delay its arrival until the full details of a law code are hammered out; it comes into existence and develops along with the clarification and extension of the system of rights.

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However surprising one may find the historical facts, they are exactly what one would expect given elementary principles of economics. In a market system, producers have a strong incentive to give customers what they want; if they do not, they will be replaced by those better able to fulfill consumer demand. Those who succeed in satisfying consumers will profit. This is the mechanism of natural selection mentioned above, and it exerts an inexorable pressure.

The state operates through an utterly different principle. As Benson accurately notes, the principal purpose of the state is the transfer of wealth. Like Franz Oppenheimer and Albert Jay Nock before him, Benson pictures the state as an instrument of coercive interference with free activity. Struggles among the Anglo-Saxon kingdoms, culminating in the Norman Conquest, dealt the non-statist Anglo-Saxon legal system crippling blows. The state took over the Law Merchant and subjected it to rigid restrictions.

The situation remains the same today. The abundant efforts of people to escape from the official legal system, e.g., through arbitration and private police, have been continually shackled by the state, a "jealous God" indeed, fearful and intolerant of all rivals.

Supporters of state provision of justice frequently rely on one weapon to defeat opponents, the famous public-goods problem. Law and its enforcement, it is alleged, generate several public goods. If, for example, police patrol a neighborhood, the benefit of deterrence of crime extends not just to those who pay for the services but to all local residents. Most of these public goods are familiar but some are rather recondite. David Landes and Richard Posner, for expample, maintain that written opinions by judges produce positive externalities, since people other than the parties to the case can use written decisions as guides (p. 279).

Benson has a double line of defense to these criticisms of private law. First, he endeavors to show that the market can internalize the externalities in question. Neighborhood associations, e.g., can require everyone who purchases property in an area to contribute to police protection. (Of course, this must be done not through compulsion but contractually.)

So far as the problem of precedent is concerned, judges do have an incentive to issue written opinions. In a competitive situation, judges need to acquire a good reputation in order to attract customers; no one can compel disputants to use them. To issue opinions that attain widespread respect is obviously one means of doing so. One might add to Benson's discussion that in the Roman Empire many legal scholars or *jurisconsults* gained recognition through their writing.

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The second string in Benson's bow is as much an attack as a defense. To think that government has any realistic chance of improving the provision of public goods by the market is fatuous. Government is dominated by bureaucrats, intent on gaining power for themselves. Special interest groups can through concentration of resources gain privileges that worsen the position of others. Benson develops his bleak picture principally through application of public choice economics. He defends it by massive citation of historical and contemporary evidence.

Furthermore, state activities tend to create their own public goods problems. Access to the courts is available to all; people do not have to pay a market price to use the state's legal services. Of course, expenses such as filing fees and attorneys' costs do limit entry, but there is no charge just for access. Overcrowding results; and the governmentally supplied resource is used inefficiently. If the market sometimes underproduces public goods, the state more frequently overproduces them.

Benson concludes that the public goods problem does not strike a fatal blow at a free market legal system. Given the manifest advantages of this system, he accordingly recommends it.

The book's outstanding argument can I think be strengthened at two points. First, the underlying assumptions of Benson's model of public goods are not entirely clear. On one model, "a public good is one that enters two or more persons' utility" (p. 273, quoting Paul Samuelson). Efficiency aims at matching utilities and costs as closely as possible.

I am far from certain, but I think this is the conception of efficiency Benson uses. Although in his hands it leads to results favorable to the free market, it is intrinsically objectionable. If taken as a welfare ideal, a glance will show that this view of efficiency is a variant of utilitarianism, subject to most of the problems of that position. This is not the place to debate ethical theory, but it is uncontroversial that utilitarianism is controversial. It cannot simply be assumed without defense.

Another way of looking at public goods has quite different implications. Here one begins with having people and property rights not subject to coercion. People may find themselves in situations where individual and collective rationality conflict, but the question facing the analyst is entirely different from that of the first model. All solutions must strictly respect property rights.

If one goes one step farther and adds the Austrian demonstrated preference principle, the problem of public goods dissolves. The principle is of course much disputed; but it seems to me that even those

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inclined against it ought to adopt a strict view of rights. Had Benson done so, he could not so easily have said: "An ideal and *permanently* limited government might be an improvement" over a complete free market (p. 373).

The second point at which the book's argument might benefit from expansion resembles the first. If efficiency is understood in loose terms as increasing wealth then it seems evident that it is an important value. But it is not the sum and substance of political philosophy, and its relation to other values needs to be examined. How would Benson reply to a defender of government who accepted his argument but claimed that other ethical principles still required a statist legal order?

I cannot guess Benson's response to this question, but of one thing I am sure. It would be a carefully considered answer, based on exhaustive research. *The Enterprise of Law* is a magnificent achievement and I enthusiastically recommend it.

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Carl Schmitt: Politics and Theory. By Paul Edward Gottfried. New York: Greenwood Press, 1990.

Economists have in recent years extended their distinctive methods of analysis to the state. According to the public choice school, government officials, like everyone else, attempt to advance their own interests. The possession of power changes their situation but leaves untouched their motivation. The state does not differ in its nature from other institutions.

Ludwig von Mises adopted an entirely different approach to the state. The state in his view rests on force. The economic or "catallactic" sphere, based on exchange, does not encompass the state. Quite the contrary, it operates on antithetical principles.

In taking this view of the state, Mises showed his affinity for a conservative tradition whose foremost twentieth-century representative was Carl Schmitt. Mises and Schmitt did not know each other, so far as I am aware, although both knew Max Weber; and Mises speaks disparagingly of Schmitt in *Omnipotent Government*. Nevertheless, the similarities are unmistakable.

Paul Gottfried's brilliant new work elucidates Schmitt's view of the state. As Gottfried stresses, Schmitt rejected the pluralism of Harold Laski, who saw the state as but one of many groups within society. This anti-political view ignored the essence of the state, its monopoly of coercive power.

Schmitt maintained that liberals overemphasized legality: their quest for a precisely organized system of legal rules was a futile effort to avoid political decision. Thus, Hans Kelsen, the leading liberal jurist of the German-speaking world and Schmitt's arch-rival, argued that every legal system stems from a basic rule or *Grundnorm*. From the basic rule, the entire legal system can be logically deduced.

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Schmitt questioned the fundamental basis of Kelsen's Pure Theory of Law. The key to sovereignty lies not in a system of principles, but rather in the power to make exceptions to customary legality in order to deal with emergencies. A state exists not by itself but as one of a group of contending powers. The chief function of the sovereign is to preserve order. Rival states need to be contained and internal factions kept in line.

Kelsen's deductive procedure bears close affinities with Mises's praxeological method in economics. But Mises's theory of the state was nevertheless closer to Schmitt's than to Kelsen's. Like Schmitt, Mises thought that the state had one key duty, the preservation of order. Unlike Schmitt, he did not stress the importance of the exception. But both Mises and Schmitt could say, with de Maistre, "The state rests on the executioner."

As Gottfried ably brings out, Schmitt refused to subordinate order to any "higher" political goals. In spite of Schmitt's reputation as a collaborator with National Socialism, "Schmitt in fact expounded a modified traditionalist view of the state that had little in common with Nazi theory or Nazi practice" (p. 3).

During the final years of the Weimar Republic, Schmitt strongly opposed the Nazis as a manifest threat to political stability. In line with his doctrine of the exception, he urged that a presidential dictatorship be established to contain both the Nazi and Communist threats. His advice was of course not followed, and after Hitler became Chancellor in January, 1933, Schmitt joined the Nazi Party. His period of effective collaboration with the Nazis came to an end in 1936; he was never the "Crown Prince" of Nazi jurists, as leftist writers endlessly repeat.

Schmitt's brand of conservatism differed entirely from the Nazis' emphasis on race and party above the state. He saw himself in the tradition of Jean Bodin and Thomas Hobbes. Bodin sought an end to the domination of French politics by religious warfare. In the *Six Books of the Commonwealth* (1576), Bodin emphasized the imperative need of the sovereign to control religious factions. Although in most cases the ruler should observe the laws and customs of the kingdom, he should be prepared in emergencies to abrogate them. Bodin did not write in an anti-religious spirit, although it perhaps goes too far to call him a "believing Catholic" *tout court* (p. 34). He may have been, but the nature of his religious views has aroused enormous dispute. His main work on the subject, the *Colloquium heptaplomeres*, is difficult to interpret.

Like Bodin, Hobbes saw the state as the sole guarantor of order. Gottfried discusses in detail Schmitt's interpretation of Hobbes,

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noting in particular Schmitt's emphasis on the symbolism of Leviathan (pp. 48–49). Hobbes thought it within the power of the sovereign to declare how Christianity was to be interpreted: his ruling bound his subjects in their outward behavior. In his discussion of Schmitt on Hobbes, Gottfried shows superb control of the immense Hobbes literature. He offers an especially valuable discussion of the Warrender thesis, the view that Hobbes was a Christain Scholastic. In addition to the articles he cites critical of Warrender, I would also recommend Thomas Nagel's essay "Hobbes's Concept of Obligation" (*Philosophical Review*, 1959).

A leitmotif of Schmitt's work was his continued efforts to demonstrate how theology gave birth to political ideas. His association of doctrines of the Trinity with imperial assertions of power in the Roman Empire, a thesis that embroiled him in furious controversy with Erik Peterson, is the most famous instance.

Occasionally, Schmitt's search for parallels between theology and politics misfired, as in his discussion of the occasionalists in *Political Romanticism*. Nicholas Malebranche and other occasionalists attributed all causation to God's direct action. Schmitt drew a parallel between this view and the Romantics' tendency to think of themselves as outside the ordinary world. To them, politics was an "opportunity of expressing their inmost selves" (p. 18).

But this misunderstands the occasionalists. Malebranche did not deny fixed order in the world. On the contrary, he saw the world as the scene of constant correlations, anticipating the position of David Hume, who knew his work well. Malebranche taught that God added necessary connection to the fixed order of the world. His philosophy was not an assertion of theological arbitrariness. Incidentally, I do not think that occasionalism has ever been declared heretical (p. 17).

To Schmitt, the analysis of intellectual movements was much more than an academic exercise. He maintained that the "tyranny of values" endangered contemporary political order. Intellectuals in the grip of abstract universals threaten to overthrow political order, principally by perfervid advocacy of democracy. Rather than view the state as the preserver of order, the democratic ideology subjects society to total politicization (p. 80). In this way it bears a close connection with totalitarianism.

Schmitt traced the contemporary "tyranny of values" in part to the ethical universalism of Immanuel Kant, who not coincidentally favored a world federation of nations. Mises did not share this position, although he was decidedly not a Kantian in ethics. But he too stressed the role of maligned intellectual doctrines in the

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overthrow of European order. Oddly enough, Mises's most extended treatment of this theme is in *Omnipotent Government*, the book that criticized Schmitt. Further, although Mises supported democracy, he did so strictly on pragmatic grounds. He had no commitment to it as an ideology.

Gottfried applies Schmitt's insights in a fascinating way to neoconservatism. Although supposedly rightwing, the neoconservatives favor total commitment to democracy in the exact fashion stigmatized by Schmitt. Their Wilsonian interventionism and worship of democracy bear no resemblance either to traditional conservatism or libertarianism. Gottfried insightfully compares Allen Bloom's universalist position with Kant's (p. 91).

Paul Gottfried has given us not only a lucid account of Carl Schmitt but also an illuminating analysis of contemporary politics. In both tasks, he displays remarkably wide-ranging and thorough scholarship. Gottfried is clearly an original thinker of high rank.

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Ingenious Yankees: The Rise of the American System of Manufactures in the Private Sector. By Donald R. Hoke. New York: Columbia University Press, 1990.

Until recent years, the history of technology used to be written, and taught, for its own sake and almost completely isolated from economic and social history. Who among us has not had his eyes glaze over at tedious recitations of the technology of the flying shuttle, or the power loom, or the open-hearth process? The treatment was tedious because treated in isolation; about all we were told of the economic effects was that these machines improved productivity and lowered costs.

This tiresome tradition came to a sudden end with the arrival of the fascinating and crucially important work of David A. Hounshell, *From the American System to Mass Production, 1800–1932* (1984), which created a new paradigm dominating the field of American technological history. Hounshell's achievement was to integrate technological with economic and social history, and bring us, for the first time, a genuine history of the development of mass production. Thus, for example, in his pioneering history of the bicycle industry of the 1890s, Hounshell showed that the bicycle was, in two ways, a critical prelude to the invention and development of the automobile because, (1) the bicycle taught consumers the possibility and the joy of individual, mobile transportation (in contrast to the mass transportation between fixed points essential to the railroad); and (2) it taught bicycle makers the technology of the wheel, the tire, and the axle. It is no accident that the first automobiles were made in bicycle shops.

But there was one troublesome aspect to this new paradigm, one that conspicuously did not fit with an economist's knowledge of the market economy and the way it operates as compared to government. Based on his own work and on the contemporaneous studies of Merritt Roe Smith, Hounshell asserted that the fountainhead of mass production was U.S. government armories. Operated by government

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and with government as their only customer, the federal armories, beginning particularly in the late 1840s, were able to give full sway to the "technological enthusiasm" of engineers, and, *heedless of cost*, could develop mass production of firearms with perfectly interchangeable parts. This aesthetically pleasing but costly method of manufacture gradually spread its way from the public sector to private mass production. Thus, modern mass production was a creation of government typically heedless of cost rather than of private entrepreneurs functioning in a market economy.

But now comes Donald Hoke, in this exciting and highly significant work, to upset completely the Hounshell-Smith picture of "Armory Practice" as the key to the development of mass production in America. While building upon Hounshell's work, Dr. Hoke stands Hounshell on his head. Hoke makes it clear that he is an old friend and colleague of Hounshell's: both of them emerging from the remarkable economic history and history of technology program of the Hagley Foundation and the University of Delaware. Hoke demonstrates conclusively that, long before Armory Practice, mass production was brought to American industry by the remarkable engineer-entrepreneur, Eli Terry. As early as 1807, Terry, an ingenious Connecticut Yankee, created a wooden movement clock industry, as a mass produced clock with interchangeable parts, completely superseding the old hand crafted clock. In 1814, Terry delivered another shock to the clock industry, by creating the highly successful wooden movement shelf clock, as compared to the "hang-up" clocks previously dominant. In contrast to the highly costly arms manufacture, Terry's clock process was adopted precisely because it drastically *lowered* costs, and could thus be sold at a very low price and create a new mass consumer market for clocks that had previously been a luxury item for the wealthy.

One of the keys to this private mass production, which Hoke shows was to become the rule throughout American industry, was that the parts were not *perfectly* interchangeable, an inordinately rigid and expensive procedure. Instead, the wooden clocks and private manufacturing in later industries, were *designed* to be not "perfect" but adjustable, with built in adjustable elements such as screws, which allowed the parts to be fitted in each unit at the final assembly. Thus, interchangeability was not "perfect," but as much as necessary. This built-in flexibility allowed mass production to cut costs; for, in contrast to government operation, the emphasis by Terry and later private producers, was on cutting costs of manufacture and on easy use by the consumer. Hence, Terry and his successors were driven, not just by technological enthusiasm, but by such enthusiasm

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intimately combined with a continuing quest to make products more cheaply and to render them more usable by the consumer. All this development was made possible by close cooperation between engineers and entrepreneurs; in this way, technology was always advanced in close collaboration with private, profit-seeking entrepreneurs for the benefit of the mass of consumers.

The next great case of mass production was the axe handle industry, developed in the 1830s and 1840s, also in Connecticut, by the creative engineer, Elisha K. Root, in collaboration with the far-seeing entrepreneur, Samuel W. Collins. Once again, the key was profit-seeking and cutting costs, and in the case of Root, in an integrated, systems approach. And rather than this mass production being influenced by Armory Practice, it was the Colt armory that hired Root, eminent from his development of axe handle factories, to manage its arms production at the end of the late 1840s. Thus, the major influence was, contrary to Hounshell, not so much from Armory Practice to private industry, as the other way around.

Donald Hoke goes on to study two other prominent cases beginning around the Civil War and also relatively neglected by historians: the intricately precise typewriter industry, and watch manufacturing as established by the Waltham Watch Company at Waltham, Massachusetts. In all cases he found the same pattern: emphasis on profit-seeking through cost-cutting and the development of a mass market; adjustable rather than "perfect" interchangeability; and collaboration between engineers and entrepreneurs. Not only that: In each and every case, Hoke found that not only was the industry private, but that there was virtually no reliance on government subsidies, or even on government contracts or purchases. The American System of mass production was private and market-oriented through and through.

Why have David Hounshell and other previous historians missed the boat so badly? Why, in particular, was the great pioneer Eli Terry virtually unknown before resurrected by Donald Hoke? Hoke's hypothesis is that Hounshell and the others have been deficient as antiquarian engineers: that is, they work solely from documentation and never from close study of the three-dimensional, old *objects* themselves. Hoke shows that Hounshell shows pictures of the objects produced in the nineteenth century only to illustrate his story, not as objects of study themselves. Hence, Hounshell and the others get the story wrong. Hoke, steeped in antiquarian engineering and in its journals, and therefore in close study of the objects themselves, was able to avoid this error.

In sum, *Ingenious Yankees* is a superb book, providing a new paradigm of American technological history consonant with sound

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economics, based on thorough scholarship and a deep study of the produced objects themselves. It combines sparkling writing, bursting with the excitement of his paradigm discovery, with meticulous detail on the specific engineering innovations and their broader significance. There are also fascinating nuggets of insight that I hope Hoke or others will pursue further. Thus, Hoke finds absolutely no labor strife in these private mass production industries, despite their often rapid technological change. This harmony contrasts, for example, with the bitterness of many craftsmen working in the Harpers Ferry Armory. It is very possible that the technological force-feeding of government operation created more resentment than the cost- and customer-conscious collaboration between entrepreneurs and engineers. Hoke also notes the fundamental error of those historians who wail about mass-production workers being reduced to skillless machine operatives, deprived of the high skills of their craftsmen-fathers. Hoke replies that, not only did mass production create many more jobs, but that the new mass production required and developed many *new* skills, including invention, production, maintenance, and repair. The new skills were different from those of craftsmen, but the skills were still extensive.

Hoke also makes some telling points about later periods in American history. He shows that even Henry Ford was engaging in misleading bravado when he proclaimed that there were "no fitters" in this mass production; on the contrary, even automobiles needed adjustments and fitting. Even on Hounshell's own turf of the bicycle industry, Hoke shows that Alexander Pope's bicycle factory was not nearly as Armory Practice oriented as Hounshell claims, that his machine tools were adjustable rather than "perfect" and that Pope's increasingly successful competitors after the mid-1880s were even farther removed from Armory Practice.

With the appearance of *Ingenious Yankees*, the history of technology has become more deeply scholarly, focusing at last on the profound study of the actual three-dimensional technological objects, and at the same time, becoming integrated with social and economic history as well as with the teachings of economic theory. In his preface, Hoke quotes the eminent historian of medieval technology Lynn White, Jr. that "the history of technology is, emphatically, fun." In the hands of Donald Hoke, at least, it certainly is.

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The Limits of Government. By David Schmidtz. Boulder, Colorado: Westview Press, 1991.

David Schmidtz's illuminating new book subjects to careful examination a key argument used to justify governmental intervention into the free market. Some economic goods, it is alleged, the market cannot produce efficiently. Roughly speaking, goods will be produced if the gains expected by their producers exceed the costs involved in their manufacture. Some goods, e.g., national defense, have features that skew the market from an approach to efficiency. The goods in question, termed public goods, are characterized by jointness of supply and nonexcludability.

If produced, they are available to everyone within a given area. If, e.g., a drive-in movie is visible from the street, anyone who passes by may watch it, not just those who bought tickets to it. If, for example, some of the passersby would have been willing to purchase tickets had the film been otherwise unavailable, then (so it is claimed) a problem exists.

The movie is underproduced. The owner of the theater takes into account only the gains from those who pay admission; he receives nothing from passersby who free ride. Private cost and public benefit in public goods diverge. To expunge the gap, various remedies have been proposed, most of which involve resort to the state.

Schmidtz begins his assessment of the public goods problem by discussing several fundamental issues of political theory.

He first analyzes the nature of justification, finding two basic sorts of reason by which political institutions can be supported. The first is teleological justification: here the institution has a feature or promotes a goal which counts as a reason for establishing or maintaining it. An emergent justification, by contrast, claims that the manner in which an institution has been established justifies it.

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Many political theorists claim that the state promotes civil peace, welfare, etc., better than alternative arrangements. Others argue that if a state arises by popular consent, it holds power rightfully. The first of these claims is a teleological justification; the second, an emergent. Schmidtz cogently argues that these two patterns constitute the principal sorts of justification for the state. As he notes, the two forms are not the only conceivable types of justificatory argument: Besides his own example, a theory that required the state to be justified both teleologically and emergently would fit neither type alone. Though neither mutually exclusive nor exhaustive, the two types are of great importance.

Schmidtz uses his classification scheme to make an intriguing claim about a style of argument popular in recent political thought. Some writers maintain that institutions are justified by what people under given conditions would rationally find it in their interests to accept. Schmidtz maintains that the apparent form of the argument masks its true character. It is not an emergent argument but rather a teleological one, since its "consent" is hypothetical. More radically, Schmidtz avers that to grasp the true force of a hypothetical consent argument, one must cast aside the imaginary story in which it is cloaked. The consent that would occur, e.g., in Rawls's original position, comes about for certain reasons. It is these reasons that bear the brunt of the argument.

Schmidtz states the essence of his case with characteristic lucidity: "The hypothetical story adds nothing whatsoever. It certainly does not add consent, for the story is only hypothetical" (p. 6). I am not sure that Schmidtz's provocative argument succeeds. Why cannot a teleological justification claim that an institution has the following good-making feature: it would be agreed upon by persons under stated hypothetical conditions?

Perhaps this sort of teleological argument always fails, and I certainly have no wish to defend it. An advocate would need to show why the feature in question added to the moral value of the institution having it. But in form, at least, I can see nothing wrong with the argument. The good-making feature is not the reason the hypothetical actors consent: it is rather their hypothetical consent itself. Schmidtz is surely correct that reasons need to be advanced in defense of the claim that consent would occur; but I cannot see that this always suffices to show the hypothetical consent does no work.

Schmidtz now turns to a subject of concern to everyone interested in libertarian theory: the Lockean Proviso. In one of its forms, this principle has seemed impossible to satisfy; it requires initial appropriators of property to leave "as much and as good" as they take for others.

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Suppose that a parcel of land is divided into one hundred lots, identical in all qualities. Further, assume that there are one hundred settlers who use the land in common. If someone takes one of the lots, he has left ninety-nine lots for everyone else. Has he left "as much and as good" for others? On one reading of the Proviso, he has not; by removing one lot, everyone else has one fewer choice available.

The problem of satisfying the Proviso becomes even more severe if one takes into account future generations. One must now leave as much and as good for those who will come into existence. Schmidtz finds it plausible to extend the Proviso in this way, although he does not specify how many generations need to be considered.

Schmidtz seems on the surface to have painted himself into a corner. He has presented a version of the Proviso which seems on its face to rule out the initial acquisition of property; yet he wishes to defend property acquisition. With a bold stroke, Schmidtz extricates himself from the difficulty; the Proviso actually mandates the acquisition of property. "*Leaving goods in the commons fails to satisfy the Proviso*. In fact, leaving goods in the commons practically insures their ruin" (p. 21, emphasis in original).

The argument Schmidtz deploys is straightforward. If land is worked in common, then individuals have little incentive to conserve resources. Persons do not bear the full cost of their actions; if, e.g., someone grazes cattle on common land in a wasteful manner, most of the ensuing costs will be borne by others. The upshot will be what Garrett Hardin has famously called a "tragedy of the commons." Since property rights have not been established, the available resources will quickly sink to nothing.

If so, Schmidtz ingeniously contends, the Proviso mandates establishment of a system of property rights. The erstwhile irremovable bar to property rights has become their chief support. If it is objected that individuals who arrive on the scene later than the original appropriators can no longer themselves acquire unowned property, Schmidtz has a ready response. The Proviso requires that future generations have resources to use, not to appropriate. They are not harmed by having to acquire property from others.

Schmidtz's brilliant discussion will be a must for all future work on the Lockean Proviso. A few clarifications and objections, however, require mention. First, a point I think Schmidtz recognizes, he has not argued that the Proviso is morally required. It is not at all obvious why original appropriators must leave as much and as good for others: if one holds a strong labor-mixture theory of original acquisition, e.g., the limitation imposed by the Proviso will seem implausible.

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It might be objected that Schmidtz has given an argument for the Proviso. Unless it is satisfied disaster will ensue through a tragedy of the commons. Is this not a very strong reason for accepting the Proviso as Schmidtz construes it? But what Schmidtz's point shows is that a society ought to have a system of property rights rather than allow unrestricted common use of resources. One need not fulfill the Proviso to meet this requirement. A system that requires individuals to bear the cost of their own waste of resources will prevent a tragedy of the commons, even if it leaves some people worse off than they would have been before the system was established. Suppose, e.g., that a few people in a society are totally denied any access to resources. The rest maintain a standard free-market system. There is no tragedy of the commons, but the Proviso is not satisfied.

Further, it is not apparent why Schmidtz deems it obvious that the Proviso must be extended to future generations. Why is it irrational to hold that one's obligations extend only to actual persons, not to persons who do not now exist? I do not argue that Schmidtz is wrong: it just is unclear why he thinks the issue requires no discussion.

To turn now to the substance of his argument; does the Proviso in fact require that property be removed from the commons? Schmidtz is of course correct that land is not being used efficiently in the situation he depicts. But it does not follow at once that a tragedy will ensue; this depends on circumstances. How much of a deviation will there be from efficient use? If the deviation is not substantial, then how strong is the requirement that enough and as good be left for others? It seems implausible that we are morally obligated to install a system providing for the highest possible degree of efficiency. If the use of land does not prevent successors from doing about as well as current users, why is there cause for complaint? (Perhaps if one took into account many future generations, however, a sorties problem might reinstate the Proviso.) It may well be, though, that Schmidtz is correct about most real-world situations, in which case his argument has outstanding practical importance.

One more difficulty needs to be treated, but this fortunately can easily be remedied. Suppose that common use does in fact result in rapid impoverishment of everyone. Has the Proviso been violated? No, since as stated it restricts only those who appropriate property; by hypothesis, there are none in the present case. But the modification of the Proviso which Schmidtz requires to meet this minor point is obvious and will be left "as an exercise for the reader."

Schmidtz continues with more provocative and insightful analysis in his third chapter; there the subject is the right of punishment.

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His surprising conclusion is that "a state can acquire an exclusive right to punish even if individuals also have a right to punish and even if they do not relinquish that right" (p. 34).

Although Schmidtz developed his view of punishment as a response to a problem in Robert Nozick's treatment of risk, he approaches matters in a very different way from Nozick. The risk that concerns Schmidtz is danger to innocent bystanders—presumably when someone tries to enforce a sentence upon a recalcitrant offender. Although Schmidtz avoids postulating a right not to be put at risk, he does assume that one has no right to impose unnecessary risks on others. If the state can reduce risks to innocent bystanders below the level prevalent in self-help enforcement, then people are no longer at liberty to punish those who have injured them.

To reiterate, Schmidtz does not contend that one forfeits the right to punish in these circumstances. Rather, one cannot exercise one's right, since an alternative exists less liable to place bystanders at risk.

Once again, Schmidtz's ingenuity compels admiration. He again and again comes up with original ideas that challenge and instruct. But should we accept his argument? I am inclined to think not. First, an analogous point to one raised in the discussion of the Proviso emerges here as well. Why should we be required to maximize safety to innocent bystanders? So long as private enforcement does not place innocent bystanders at substantially more risk than does state enforcement, why should one insist on the least possible risk (consistent with having sentencing at all)? As will later be apparent, Schmidtz himself uses the distinction between "good enough" and "best possible" in his later discussion of public goods; does it not also apply here?

Further, why does Schmidtz think it likely that private enforcement will be riskier to bystanders than state enforcement? Perhaps he has in mind something like this: I attempt to take back my wallet from a thief. He sees no reason to return it to me, and in the ensuing struggle, people are injured. Had the police dealt with the thief, the bystanders could breathe a sigh of relief. Although on occasion criminals "shoot it out" with police, resistance is much less likely to occur.

No doubt matters often take place in the way just described. But it does not follow from this that individual enforcers need abandon their activities. They need only choose their opportunities carefully. They can, e.g., take care to have sufficient force to deter the criminal from resisting. One way to do this is to hire a private protection agency to enforce judgment: If the agency were sufficiently powerful, resistance seems an unlikely prospect for the same reason that

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relatively few people resist arrest by the police. Another possibility is to pick one's spots carefully so that no innocents stand in danger.

Suppose, however, that Schmidtz's picture perfectly matches reality: A single dominant protection agency is vastly less liable to expose bystanders to danger than any combination of independents. Have we obtained a state? I cannot see that we have. It might be the case that the single agency able to enforce sentences could do nothing else. The mandate for punishment would always come from an independent. I do not claim this possibility is more likely to arise than the one Schmidtz envisions, but only that his argument does not exclude it.

A strong point of Schmidtz's work is that he attempts to meet in advance objections to his argument. One such objection suggests, following Guido Calabresi and A. Douglas Melamed, that injury to innocent bystanders be handled differently from Schmidtz's approach. Instead of prohibiting independents from enforcement, why not compensate innocents who are injured?

To this Schmidtz replies that the bystanders are being subject to pointless risks. Thus, the case should be governed by a property rather than a liability rule, to use Calabresi's terms: Prohibition rather than compensation is the indicated course.

Schmidtz's supposition of pointless risk does not cover all relevant cases. What if the state does not impose exactly the same punishment as the independent would have done? What if the state finds the criminal innocent, or fails to take up the case at all? Here one cannot say the risk is pointless—even if Schmidtz's argument were otherwise acceptable, it would not apply to independents in these circumstances. But what of instances in which Schmidtz's account exactly fits? I am not sure that even in this type of case, the risk is pointless: what if someone values protecting his own rights? But what if the risk *is* pointless? Schmidtz gives no argument that prohibition rather than compensation is the proper course to follow. But I have no argument to offer that he is wrong.

Schmidtz introduces the principal topic of his book, the provision of public goods, with an excellent analysis of the Prisoner's Dilemma. Many writers view the supply of public goods as raising the same problem as the classic Dilemma: supplying the good is collectively rational; but, for each person, refusal to cooperate in its supply dominates contributing. Since no person's actions will substantially affect supply of the good, everyone individually seems better off refusing to contribute, regardless of what others do.

Schmidtz very usefully divides the difficulty of securing cooperation into two parts. On the one hand, the familiar free-rider problem arises: Although everyone is better off if the public good is supplied,

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for each person refusal to contribute dominates contributing. On the other hand, the free-rider problem, as Schmidtz convincingly shows, does not exhaust the difficulty of the Dilemma. He draws attention to the assurance problem: People willing to contribute do not wish their contributions to go to waste by failure to secure enough donors to produce the good.

Does the problem of supplying a public good, analyzed as a Prisoner's Dilemma, require forcible intervention for its resolution? Schmidtz does not think so; he shows that voluntary agreement suffices. His solution accents the assurance problem. A universal contract will suffice to prevent contributions from being forfeited without result. The terms of such an assurance contract provide that everyone agrees to contribute to the provision of the public good, if and only if everyone else does. Further, with a unanimous agreement, the remaining obstacle to a cooperative solution also dissolves. There are no free riders, and individual rationality now coincides with what best secures the welfare of the group (p. 57).

One might at first object that Schmidtz has by his assurance contract merely pushed back the difficulty. How is compliance with the contract to be secured? Will this not in turn generate another Prisoner's Dilemma, this time to be resolved only by force? To this difficulty Schmidtz has a response: Contract enforcement is not a public good since it is not characterized by jointness of supply. Those who do not purchase this good will not secure the enforcement of their contracts.

If it is now objected that contract enforcement depends upon force, Schmidtz once more has an ingenious reply. Signers of a contract cannot rightfully complain if they are compelled to observe its terms, since they have agreed to do so. The agency that in fact enforces contractual arrangements cannot then be legitimately questioned, since it might have arisen voluntarily.

But what if it did not? Schmidtz now produces the ingenious counter just mentioned. Even if the enforcement agency has not arisen through voluntary agreement, its activities do not depend on its having arisen through the use of force. The reason for this is just that an enforcement agency might have arisen voluntarily: How the agency arose does not affect the legitimacy of its present activities. (How it arose may of course affect whether it, rather than some other group, is best entitled to perform these activities.)

Thus Schmidtz has virtually completed his case. Public goods can be produced voluntarily, and nothing in the means required to do this need violate rights. This part of Schmidtz's argument seems to me eminently successful. One point that might require further

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development has to do with the existence of individual property rights, necessary for a free market to function. To fully complete his case, Schmidtz needs to show that these rights do not depend essentially on the use of force for their establishment. I see no reason to think that this cannot be done.

A unanimous assurance contract by no means puts paid to all problems about public goods. Not all public goods can be analyzed as a Prisoner's Dilemma game, the players of which are a society's entire population. Some people may not regard the public good as desirable at all: Opponents of United States foreign policy, e.g., will not wish to purchase the "public good" of national defense. Others may rate certain public goods as worth less to them than the contribution required through an assurance contract.

Why not then confine the assurance contract to those who do think the public good worth securing? In Schmidtz's view, this solution generates a further problem. Some people may actually want the good; but, knowing that those who do not are not required to contribute, they may disguise their true wishes. Falsely pretending to be genuine holdouts, they hope by their strategic behavior to gain the good for nothing. The free-rider problem reemerges.

A further difficulty complicates the public goods problem even more. Unanimous consent is in practice intolerably cumbersome to achieve: It is likely that the market solution will consist of an assurance contract of fewer than the total number of those who want the good. The number required will vary with the minimum number needed to produce the good (unanimous consent will presumably still be required for a pure public good, in which no coalition suffices for its production). Once more free riders threaten.

Schmidtz suggests several principles to aid in the solution of these problems. He sets forward conditions under which he thinks people stand under an obligation to contribute to the provision of public goods they want. But obligation does not generate by itself liability to be coerced by others, should one fail to fulfill one's duty. Because of the tendency of government officials to advance their own interests, abundantly documented by public choice economists, it is highly unlikely that government intervention will bring about a better state of affairs than the free market. On the contrary, it is a safe bet that the government will worsen things. Schmidtz accordingly holds that the government should stay out of public goods provision, except in emergencies in which immediate action is required to prevent the destruction of society.

Schmidtz does not confine himself to a purely speculative account of how the market *might* produce public goods. He describes several

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experiments, some of which he helped to design himself, which have endeavored to determine how people might handle public goods provision. The experiments provide some evidence for the view that people will voluntarily agree to produce public goods, although their behavior does not conform to theoretical models of rational choice. To those who object that the experiments are artificial, not genuine tests of market behavior, Schmidtz has a clever answer.

Theories of public goods production should, if correct, apply to experimental situations, since these fall within the scope of the theories' postulates. The experiments Schmidtz describes thus are more than simulation of actual market behavior: they are themselves "real-life" tests.

Austrians may be inclined to look on experimental economics with a jaundiced eye, but I think Schmidtz escapes danger from this front. He does not claim that he has an airtight model, deductively derived from self-evident axioms, specifying when it is rational for persons to contribute to public goods. He need not be taken as committing himself to the view that all economic theory requires empirical verification.

On another point, though, Schmidtz's analysis sharply contrasts with a Misesian position. On the "demonstrated preference" view, only persons' actual choices are counted as genuine preferences. Counterfactual preferences are banned from praxeological analysis. As one can readily imagine, this has quite drastic consequences for the public goods problem; Hans Hoppe, most notably, has used demonstrated preference in an attempt to undermine standard accounts of public goods.

I strongly suspect that Schmidtz thinks this view mistaken. I wish he had spent at least a short time discussing the issue, as the question is of concern to many philosophers and economists of free-market orientation. But given the wide range of topics Schmidtz does cover, I am no doubt unfair in my complaint.

To return from Austrianism to Schmidtz, his skepticism about the role of government in the supply of public goods seems eminently justified. His careful distinction between obligation and liability to coercion is particularly excellent.

On one point, however, Schmidtz might usefully have extended his skepticism. He assumes that free riding, and perhaps certain other kinds of strategic behavior, are morally questionable. Thus, he holds that if one benefits to a sufficient extent from a public good, one ought to contribute to its production. Further, though I may be mistaken, I think he finds morally problematic pretending for strategic reasons to be a holdout.

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Though most philosophers interested in this area agree with Schmidtz, I do not think it at all obvious that something is wrong with free riding. *Prima facie*, the free rider (or strategic bargainer) is acting to secure his own interests: what exactly is his moral offense?

It might be said that free riding prevents a group from maximizing its collective welfare. But why is this a reason to hold the practice morally wrong? Is one under an obligation to avoid interfering with the use of resources to maximize collective welfare? On certain consequentialist views, the answer is yes; but these positions cannot simply be assumed as given.

Schmidtz might reply that this objection underestimates the force of the considerations against the free rider. It is not only the group that will benefit if no one free rides: With an assurance contract, everyone, including potential free riders, will be better off than if each person is free to act as he pleases. But this at most shows that one would be irrational (or not rational in Schmidtz's sense [p. xvi]) in refusing to sign an assurance contract. An additional premise is needed to generate a moral obligation.

Schmidtz, as one might expect, knows this full well and has just the moral premise that will do the trick. His feedback theory of morality tests moral norms by the question: "Is this norm conducive to a cooperative society's success, given how people will react both to it and to agents guided by it" (p. 153)?

Granted that social cooperation is a *conditio sine qua non* of human happiness and survival, does it follow that one must take maximizing cooperation as the test of morality? Why is it not sufficient to secure some threshold of cooperation, after which this value might find itself in competition with other values? This point generalizes a criticism made earlier about Schmidtz's discussion of the Proviso. From "x is good," the further statement "maximize x" does not follow. Of course, I have not shown that one should *not* aim to maximize social cooperation: The point, rather, is that the matter is more controversial than Schmidtz allows.

The case against the free rider suffers from a more fundamental flaw. The argument against him, very roughly, is that cooperation is desirable; free riding impedes cooperation; therefore, free riding is *prima facie* objectionable. A problem with this argument emerges if one considers once more Schmidtz's convincing analysis of the Prisoner's Dilemma.

In that analysis, two problems produce the Dilemma: besides the free rider difficulty, there is also an assurance problem. If free riding is objectionable just because it impedes cooperation, why is there no similar objection to someone wishing assurance that his contributions

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will not be wasted? Schmidtz does not call for the curtailment or reduction of the desire for assurance; instead, he caters to this desire through the assurance contract. Why the difference? The objection to free riding cannot *just* be that it blocks cooperation. What then is it?

I fear that I have gone on too long, but this is an endlessly fascinating book. Many of its themes I have had to omit: I think particularly of the illuminating discussion of what Schmidtz terms the concatenated Prisoner's Dilemma (pp. 101–02)[1] and the use of his feedback theory to derive a rule of reciprocity in cooperative ventures.

The Limits of Government is an outstanding work, manifesting the remarkable philosophic talent of its author.

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[1]Schmidtz suggests, following David Kreps, that someone playing an iterated or concatenated Dilemma with an opponent having an established reputation for reciprocity ought rationally to cooperate rather than use the backward induction paradox to justify noncooperation. But might the paradox interfere with developing such a reputation?

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